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FINANCE FACTS YEARBOOK

1987 FINANCE FACTS YEARBOOK

A Factbook About Consumers and the Consumer Finance Business

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FOREWORD

Finance Facts Yearbook is an annual publication of the American Financial Services Association which also publishes the monthly "Finance Facts" and research reports on consumer financial matters. These and other publications are offered at a nominal charge as a public service by the American Financial Services Association, whose members number 550 companies providing financial services to consumers through over 11,000 offices in the United States and Puerto Rico.

AFSA's membership is comprised of nonbank financial companies including organizations commonly referred to as consumer finance companies, sales finance companies, industrial banks, industrial loan companies, retailers and others. Some members have insurance and retail subsidiaries, some offer commercial financing, some have manufacturing subsidiaries, some operate in Canada and some in Europe, Australia and Asia. Some members of AFSA are subsidiaries of highly diversified parent corporations, while others are subsidiaries of manufacturing companies, others of insurance companies, and others of bank holding companies.

The first six chapters of the yearbook provide a convenient reference source of current information about significant aspects of the consumer sector. The human factors are briefly outlined: the size and make-up of the population as the underlying determinant of the types of goods and services needed; and the size and make-up of the adult population as the potential labor force to supply those goods and services. A review of consumer income, expenditures, saving and investment is followed by a description of consumer credit and the institutions involved.

Chapter 7, "The Consumer Finance Industry," provides a description of the business of finance companies and industrial banks, their markets, their sources of funds and other distinguishing characteristics of these financial institutions. Included is a brief account of the legal and regulatory framework within which these companies operate as well as the latest statistical information relative to finance company operations. One section of Chapter 7, "DIDMCA" relates the implications for finance companies of the implementation of provisions of the Depository Institutions Deregulation and Monetary Control Act of 1980. A new section has been added this year to Chapter 7, dealing with a currently "hot" topic: personal bankruptcy.

Finally, the "List of References" may be helpful to those who wish to obtain more information on the consumer finance industry.

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THE POPULATION

The size and composition of the population are important determinants of the extent of consumers' demands for goods and services and of the types of products required to satisfy them. Demographic and geographic characteristics, the education and mobility of the population, as well as other characteristics, are important factors in determining the amount consumers will save, invest, spend, and, more indirectly, in determining the types of goods produced. The size of the labor force, for example, places one restraint on the goods and services made available by any economy. Historically, long term growth has been a feature of the United States economy, and has been possible in part through the existence of a large and growing skilled labor force, a wealth of entrepreneurial spirit and ambition, and constantly developing technology within a stable political system.

To provide the goods and services sufficient to satisfy the demands of the entire U.S. economy, well over half of the population contribute to production, either in the labor force or in the home. Almost one-fifth of the U.S. population is currently in some kind of educational pursuit, presumably in the interest of securing for the future the productive capacity of our economy. The resident population of the U.S. excluding members of the Armed Forces overseas, was estimated at over 242.2 million as of December 31, 1986 (241.5 as of July 1, 1986 in our time series). Of the 242 million, about 118 million (49%) were in the labor force and about 47 million (19%), were in school full-time (Chart 1). Many of these students were also working, at least part-time.

CHART 1

As demographic characteristics of the population are important in determining current patterns for spending, saving, and production, projections about these characteristics permit some advance planning for use of resources by individuals, business and government. The following sections provide data on some of the more relevant demographic determinants of economic activity.

Population Growth and Family Formation

The population of the United States excluding members of the Armed Forces overseas was estimated in mid-1986 to be 241.5 million, an increase of 0.8% over the previous year. By 1990, it is expected to increase by about 3.4% to stand at approximately 249.7 million.

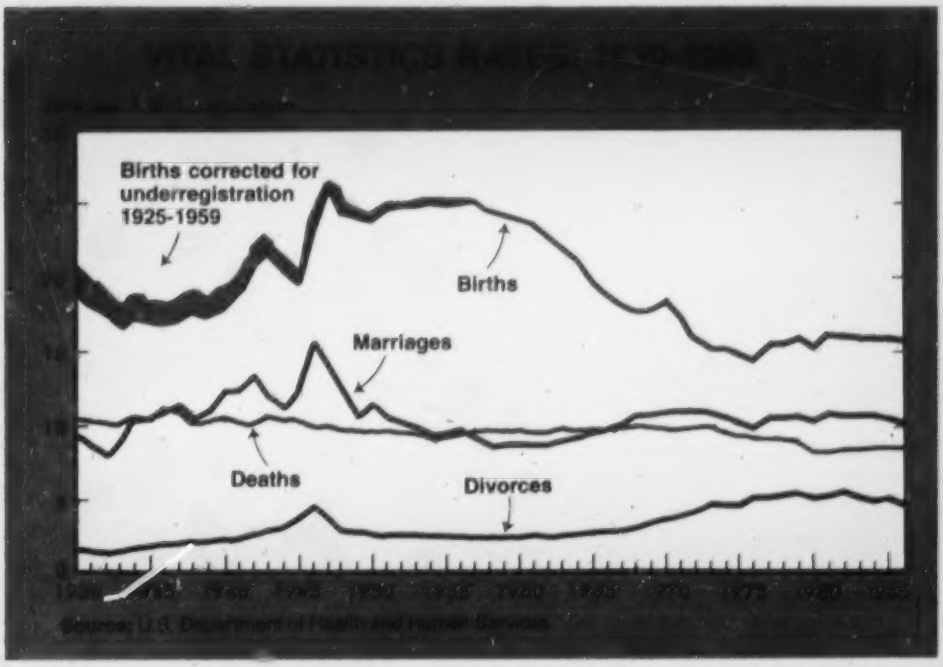
Chart 2 shows the birth rate maintaining a very steady pattern that began generally late in the 1970's, after falling steadily since 1957. The 1986 increase in population is consistent with the less than 1% growth rates that resulted in part from declining birth rates and have maintained since the late 1960's.

Data available from the U.S. Department of Health and Human Services provide some detail on the composition of the year's increase in resident population. Preliminary figures show a natural increase in population (the excess of births over deaths) during 1986 of 1,632,000 persons, or 0.7%, the same rate of increase as in 1985. The remaining population increase is due to immigration. The number of births was lower in 1986 than in 1985 while the number of deaths was higher. An estimated 3,731,000 babies were born in the U.S., 0.5% less than in 1985. While the number of women in the childbearing ages (15-44 years) increased by 1%, the fertility rate was 2% lower in 1986 than in 1985. The fertility rate in 1986 (64.9 live births per 1000 women of childbearing age) is the lowest rate ever observed in the U.S.

The number of births yielded a birth rate of 15.5 births per 1,000 population, as mentioned, a little lower than in 1985. The total number of deaths was 2,099,000 which was the largest number ever reported for the U.S.; there was no change in the death rate, which remained at 8.7 per 1,000 population.

During the 1960's the number of marriages increased steadily from the 1958 low of 1.45 million, reaching 2.28 million in 1973. There was then a decline to 2.13 million in 1976, followed by a gradual rise to almost 2.5 million in 1982. In 1983 the number of marriages declined for the first time since 1975 to 2.444 million. There was another decline in 1986,

CHART 2



to 2,400 million marriages. The marriage rate per 1000 population decreased in 1983 to 10.5, lower than in 1982, and maintained at that level in 1984. The rate declined again in 1985 to 10.2 and fell further in 1986 to 10.0. This is the lowest marriage rate since 1977. The divorce rate, which had increased rapidly since 1971, had dropped for three consecutive years leading up to 1984. In 1985, there was an increase in divorces of 2% over 1984, followed by a drop of the same magnitude in 1986. Thus, the number of divorces in 1986 fell 2% to 1,159,000.

Age Groups

The number of persons in various age groups also imposes requirements on the economy, particularly in the areas of education, the job market, and the market for various other products.

TABLE 1

POPULATION INCLUDING ARMED FORCES ABROAD BY AGE AND SEX JULY 1, 1981-2000
(In millions)

	1981	1282	1983	1984	1985	1986	Projected 1990	Projected 2000
Total.....	230.1	232.5	234.8	237.0	239.3	241.6	249.7	268.0
By Age								
Under 5.....	16.9	17.3	17.7	17.8	18.0	18.1	19.2	17.6
5 to 15.....	38.2	37.9	37.7	37.7	37.7	37.7	38.6	42.1
16 to 24.....	38.6	38.0	37.4	36.7	36.0	35.4	32.3	32.2
25 to 34.....	39.1	39.7	40.6	41.4	42.2	43.0	43.5	36.4
35 to 54.....	49.1	50.6	51.8	53.1	54.4	56.0	63.2	80.8
55 to 64.....	22.0	22.1	22.2	22.3	22.3	22.2	21.1	23.8
65 and over..	26.3	26.8	27.4	28.0	28.5	29.2	31.8	35.0
By Sex								
Under 16								
Male.....	28.2	28.2	28.3	28.4	28.5	29.0	29.6	30.6
Female.....	26.9	26.9	27.0	27.1	27.2	27.2	28.2	29.2
16 to 24								
Male.....	19.5	19.3	18.9	18.6	18.3	17.9	16.4	16.4
Female.....	19.0	18.8	18.5	18.1	17.8	17.4	15.8	15.8
25 to 54								
Male.....	43.5	44.6	45.7	46.8	47.8	49.0	52.9	58.4
Female.....	44.7	45.8	46.8	47.8	48.8	49.9	53.8	58.8
55 to 64								
Male.....	10.3	10.3	10.4	10.5	10.5	10.5	9.9	11.3
Female.....	11.7	11.8	11.8	11.8	11.8	11.8	11.2	12.5
65 and over								
Male.....	10.6	10.8	11.1	11.3	11.5	11.8	12.7	13.7
Female.....	15.7	16.0	16.4	16.7	17.0	17.3	19.1	21.3
Total								
Male.....	112.1	113.2	114.4	115.5	116.6	118.0	121.5	130.4
Female.....	118.1	119.3	120.4	121.5	122.6	123.6	128.2	137.6

Source: Bureau of the Census
Note: Parts may not add to totals due to rounding

Table 1 details the U.S. population, including Armed Forces members residing abroad, by age group and within age group by sex as estimated for the years between 1980 and 1986, and as projected by the Census Bureau for the years 1990 and 2000. While the total number in each group is of interest for present-day current production and marketing plans, the rate at which the size of these groups is changing is of greater concern, for purposes of planning, to business and government. The changes in the size of the various age groups from 1980 to 1986 and as projected are shown in Chart 3.

The number of young people at home or in school, i.e., those under 16 years of age was almost the same in 1986 as in 1975 at just over 55 million. The group grew by only 0.5 million between 1980 and 1986, but is expected to increase by 2.0 million between 1986 and 1990 and by 1.9 million between 1990 and 2000. The number between 16 and 24 years declined 0.6 million during 1986 to 35.4 million, as the "baby boomers" continue to age out of that bracket. This group will continue to shrink as the century reaches its end, the projection for the year 2,000 being as low as 32.2 million persons.

The largest segment of the population, and the most homogeneous in terms of labor force participation and thus productivity, those between 25 and 64 years of age, (most of whom are either in the labor force or work at home) numbered 2.3 million more in 1986 than in 1985 and 13.2 million more than in 1980. This group will grow to approximately 128 million by 1990, and to about 141 million between 1990 and 2000. The population 65 and over, most of whom are retired, number 0.7 million more in 1986 than a year earlier and 3.5 million more than in 1980.

Households

Trends in family formation and in the number of households are of particular economic significance because the primary unit of consumption is in many cases not the individual but the family or the household. This is certainly the case for housing and consumer durable goods such as automobiles, home furnishing and appliances. If present trends in family and household formation continue and the long-term trend in economic activity continues generally upward, it is anticipated that the number of households will increase from 88.5 in 1986 to about 94 million in 1990 and 106 million in 1995.

The 88.5 million households in the U.S. in March of 1986 represented an increase of 7.7 million households since 1980. About 52% of the 1986 increase from 1980 (4.0 million households) consisted of family households, while 48% (3.7) of the increase consisted of nonfamily households. Note that roughly half of the increase in households was thus accounted for by a group that now comprises only 28% of actual households. One result of such changes in household composition has been a drop in average number of persons per household. This figure has dropped off steadily, with the exception of one increase in 1983, since 1964 when the average household size was 3.33 persons. The 1986 average reached a new low of 2.67. The change has resulted from the falling birth rate since the 1960's (which is reflected in a steady decrease in average number of children under 18 years of age per household from 1.23 in 1964 to 0.71 in 1986) and the increasing proportion of adults who are living alone (17% of households in 1970 compared almost 24% in 1986). Average population per family (of related persons) dropped from 3.70 in 1964 (not its all-time high) to 3.21 in 1986. Clearly both the increasing number and the smaller size of households has economic implications.

Regional Population and Mobility

The location and mobility of the population, in addition to its size and other features, is another important factor in determining what and where the country's economy will be required to produce. The location of an industry's center or the need to transport finished or unfinished products across the country can be greatly affected by movements or geographical shifts in the population, just as changes in industry can affect the mobility and geographical distribution of the population. The highest mobility rates usually occur among persons in their twenties. Many are

in the process of establishing households, starting new jobs, finishing school, service in the Armed Forces, or have been recently married. In their later twenties, many are buying homes or moving to larger living quarters because of growing families, or are moving to housing more convenient to schools.

In the period between March 1982 and March 1983 about 16.6% of the U.S. population moved to a different residence within the United States. Comparison with the rates of the early 1970's and 1960's shows a steady decline in residential mobility (the rate in 1960-61 was 20.6% and in 1970-71 18.7%). The decrease seems primarily due to the lower rates of local moves (moves within the same county). By educational attainment, mobility during this period was as follows: 10.1% of persons with 8 or fewer years of school completed had moved to a different house in the United States, while 15.8% of those with 4 years of high school and 17.4% of those with at least 4 years of college had moved.

TABLE 2

HOUSEHOLD AND FAMILY STRUCTURE OF THE U.S. POPULATION*
(In millions)

						Projected**	
	1970	1983	1984	1985	1986	1990	1995
Total Resident Population.....	205.1	234.3	236.5	238.7	241.5	249.7	252.6
Households.....	63.4	83.9	85.4	86.8	88.5	94.2	105.9
Family Households.....	51.5	61.4	62.0	62.7	63.6	66.8	72.3
Married-Couple Family	44.7	49.9	50.1	50.4	50.9	53.0	56.3
Other Family							
Male Householder...	1.2	2.0	2.0	2.2	2.4	2.6	3.3
Female Householder.	5.5	9.5	9.9	10.1	10.2	11.2	12.7
Nonfamily Households...	11.9	22.5	23.4	24.1	24.9	27.5	33.7
Male Householder...	4.1	9.5	9.8	10.1	10.6	11.9	15.5
Female Householder.	7.9	13.0	13.7	14.0	14.3	15.5	18.2
Memo: Living Alone***.	10.9	19.3	20.0	20.6	21.2	na	na

Source: Bureau of the Census

Note: Parts may not add to totals due to rounding.

* Population and projected households as of July 1 of each year; estimates of households for years 1980 through 1985 are as of March.

** Population growth conforms to the Census Bureau Series II projection which is the middle estimate of three projections. Projections of number of households are the Census Bureau Series B based upon trends in marital status and householder proportions over the 1964-1978 period. A household consists of a person or group of persons who occupy a house, an apartment or other group of rooms, or a room that constitutes a housing unit. A family household requires at least 2 persons: the householder and one or more additional persons related to the householder through birth, marriage or adoption.

***Of the non-family households, those that constitute one-person households.

Population Change by Region

The U.S. population grew by 11.4% between 1970 and 1980. Between 1980 and 1985, the increase was 5.3% (12.2 million). Of this 5.3%, more than 91% was in the South and West. Growth in various regions of the country is shown in Chart 4. Gains in resident population higher than the overall U.S. gain between 1970 and 1980 occurred in the Pacific, Mountain, West-South-Central, East-South-Central and South Atlantic States. Between 1980 and 1985, growth was higher than the overall 5.3% in the same group of regions with the exception of the East-South-Central States. Declines in resident population occurred in the Mid-Atlantic States during the earlier period and in the East-North-Central States since 1980. This decline, however, slowed in 1985. Part of the differential in rates of population growth is explained by differing birth rates, but most of the difference has resulted from changing economic developments and the highly mobile character of the population of the United States. In the West and South, just over half of the growth was due to migration.

CHART 3

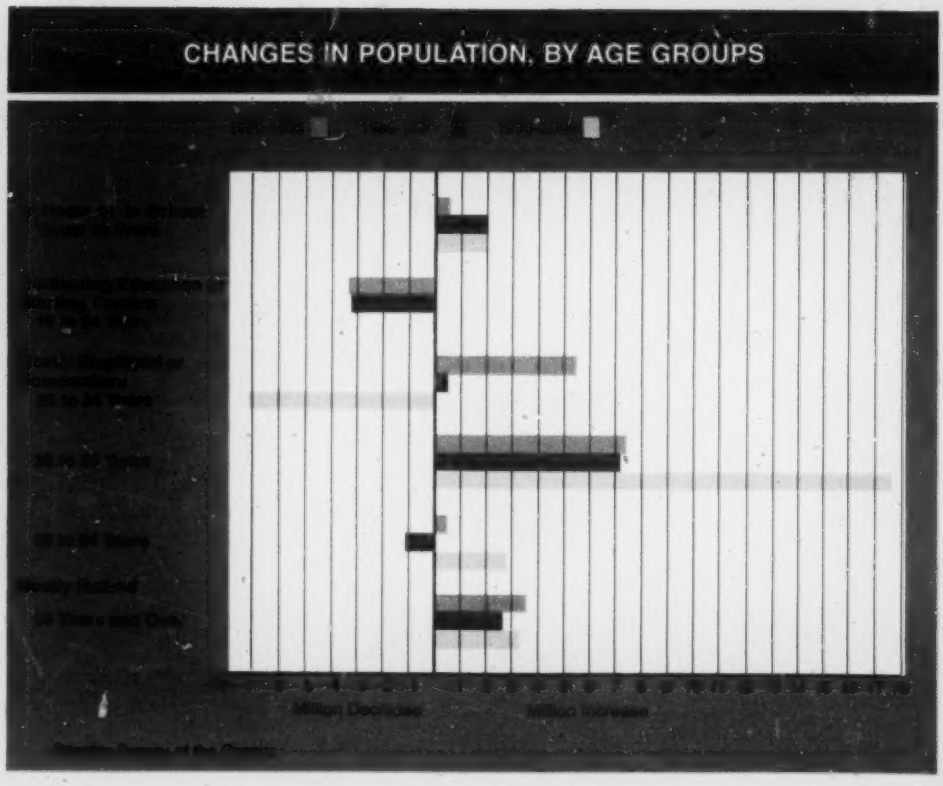
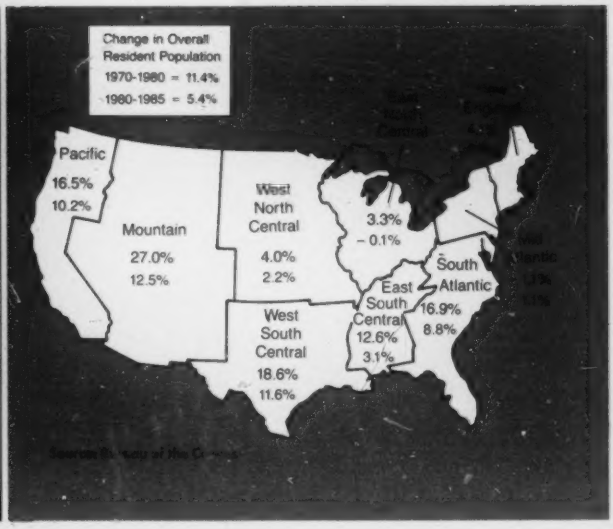


CHART 4

CHANGES IN RESIDENT POPULATION BY REGIONS, 1970-1980 and 1980-1985

Key:
Top Number = 1970-1980
Bottom Number = 1980-1985



2

OCCUPATIONS OF THE POPULATION

The potential of an economic system to provide goods and services to satisfy the demands made of it is limited by the size and skills of its labor force and by its managerial capabilities. The quality of a present-day work force is a product of past education and training. The continued productivity of the labor force will also depend on education and training, and on a multitude of government policies and incentives, both intended and unintended.

Labor Force

The potential labor force, defined as the noninstitutional population 16 years of age and over, consisted of an average of 182.3 million people in 1986, 1.3% larger than in 1985 (Table 3).

The actual labor force, defined by the Department of Labor and the Bureau of the Census as those persons employed and looking for employment, was about 119.6 million in 1986, 2.1% larger than in 1985.

Those 16 years of age and over who were not in the labor force, i.e., those keeping house, going to school, unable to work and retired, numbered 62.7 million. The labor-force participation rate was thus 65.6% among the noninstitutional population 16 years of age and older, near the highest level ever recorded in this country.

School Enrollment

Approximately 58 million persons between the ages of 3 and 34 were enrolled in schools or colleges in the United States either full or part-time in October, 1985 (Table 4). The students comprised 47.1% of the total resident population in this age group, a little higher ratio than was measured for 1984 (46.8%). School enrollment among children 3 and 4 years old has increased markedly since 1970. In 1970, there were 1.1 million children enrolled in nursery school, compared with 2.5 million in 1985. This increase is primarily due to higher enrollment rates among 3 and 4 year-olds, rather than any drastic increase in the number of eligible nursery schoolers. In 1973, only 17.7% of 3 to 4 year olds were enrolled in nursery school and by 1985 the figure had risen to 34.5%. This increase is certainly at least in part due to the increasing labor force participation rate as families with both parents working become more common. In the same period, the overall labor-force participation rate has risen from 61.3% to 65.6% and that among women 16 years and older from 44.7% to 55.4% currently.

The long-term decline in the number of younger children, however, has caused gradual decline in the grade school population. Elementary school enrollment peaked

TABLE 3

LABOR FORCE PARTICIPATION OF THE POPULATION
16 YEARS OF AGE AND OLDER, 1981-1986
(In millions of persons, annual averages)

	1981	1982	1983	1984	1985	1986
Noninstitutional Population*	172.3	173.9	175.9	178.1	179.9	182.3
Labor Force including resident armed forces	110.8	111.9	113.2	115.2	117.1	119.6
Armed forces	2.1	1.7	1.7	1.7	1.7	1.7
Civilian labor force	108.7	110.2	111.6	113.5	115.5	117.9
Employed	100.4	99.5	100.8	105.0	107.2	109.6
Unemployed	8.3	10.7	10.7	8.5	8.3	8.2
Not in labor force	61.5	62.1	62.7	62.8	62.7	62.7

Source: Bureau of the Census and Bureau of Labor Statistics.
Note: Parts may not add to totals due to rounding.

*Does not include those in mental, penal or welfare institutions.

TABLE 4

ESTIMATED SCHOOL ENROLLMENT 1981-1985*
ALL LEVELS, 3 to 34 YEARS OLD
(In thousands)

By Grade	1981	1982	1983	1984	1985
Nursery school	2,031	2,153	2,350	2,354	2,491
Kindergarten/Elementary school	31,513	30,711	30,559	30,322	30,681
High school (grades 9-12)	14,935	14,123	14,010	13,777	13,979
College or professional school	10,473	10,919	10,825	10,859	10,863
Total	58,935	57,905	57,745	57,313	58,014

Source: Bureau of the Census

Note: Parts may not add to totals due to rounding.

* As of October of each year.

in 1970 at 34.0 million. By contrast, 1985 saw the total of kindergarten and elementary school enrollment at less than 30.7 million. High school enrollment in 1985 rose from 1984 to 14 million, about 1.7 million below the 1975-77 peak. On the other hand, high school dropout ratios and totals decreased as well during this decade as opposed to 10 years earlier. The Census Bureau reported that the dropout rate went down from 6.3% in 1972-73 to 5.2% in 1982-83. Similarly, the number of dropouts decreased from 683,000 to 535,000 in the same time period. As the "baby boomers" have left the elementary and high schools, there has been a significant increase in the number of college students since 1970. The total number reached 10.9 million in 1982 and fell slightly to 10.8 million in 1983. It was virtually unchanged in 1984 and 1985. From 1970 to 1985, the overall increase in the number of college students was 47%, and between 1965 and 1984, 92%. From 1970 to 1982 the majority of the increase in college enrollment was due to the growth in college attendance by women (3 million in 1970, 5.5 million in 1985). In fact, in 1982 there were 100 thousand more women than men enrolled in college. The number of women college students declined somewhat in 1983 and 1984 and fell below the number of male college students. In 1985 however, women college students outnumbered the college male population over 170,000.

The long term increases in both the number and proportion of female college students coincide with other social and economic changes that have emerged recently among women such as marrying later, increased participation in the labor force, and continuing to work after children are born. The proportion of women in the labor force has risen steadily since 1970, the civilian labor force average participation rate for women having risen from 43.3% in 1970 to 55.4% in 1986. Since 1978, more women have participated in the labor force than have not.

Labor Force Participation

The total labor force, including members of the Armed Forces, averaged 119.6 million in 1986, up 2.4 million, or 1.3%, from 1985 (Table 3). With no change in the number of Armed Forces members, the civilian labor force also rose by 2.4 million.

CHART 5

CIVILIANS 16-24 YEARS OF AGE IN SCHOOL AND IN THE LABOR FORCE 1970 AND 1986

Source: Bureau of Labor Statistics

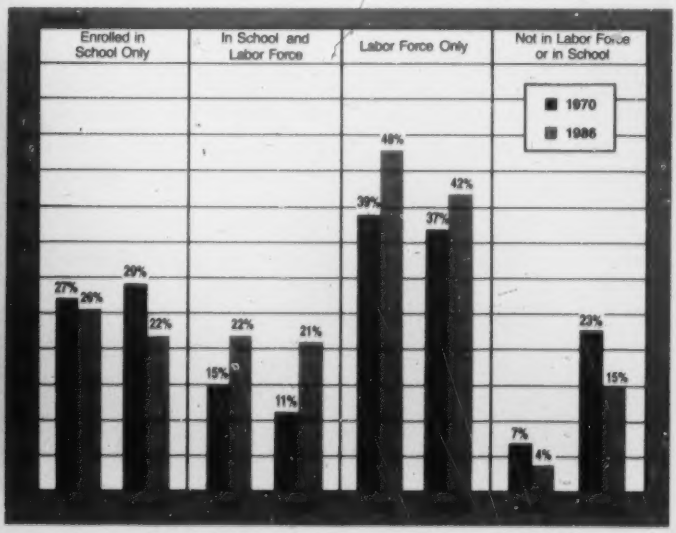
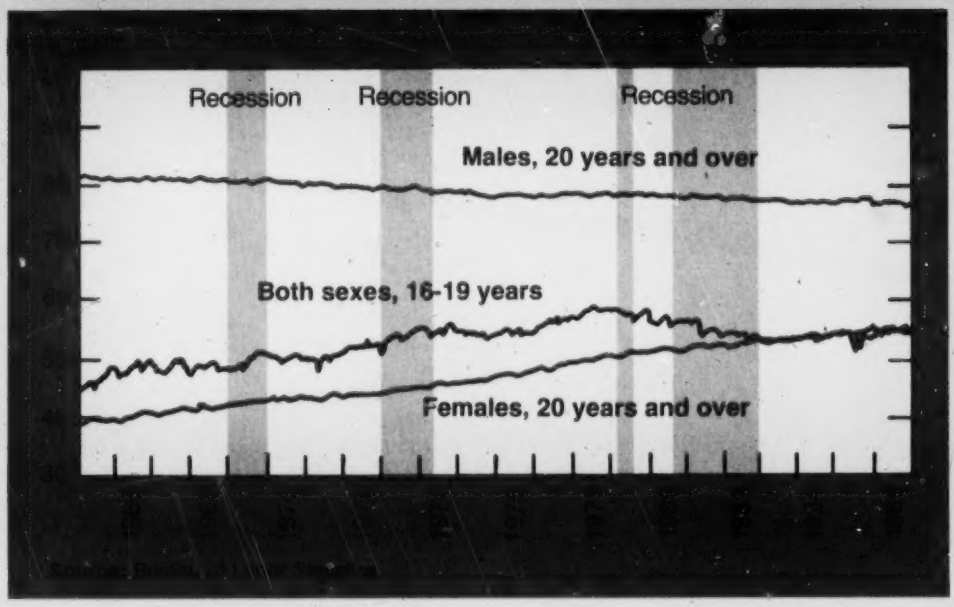


CHART 6

CIVILIAN LABOR FORCE PARTICIPATION RATES BY SEX AND AGE, 1965-1986

(Seasonally Adjusted)



Average civilian employment for the year had decreased by almost 1 million to 99.5 million in 1982 (the first such decrease since 1975). This decline was recovered in 1983 and the average civilian employment since has risen to 109.6 million. In 1986, the average number of unemployed persons fell back to less than the 1981 level. With labor force and employment growing well and unemployment declining, 1986, like 1985, was again an excellent year on the overall employment front.

Distributions of young people (16-24 years of age) in school and in the labor force are shown in Chart 5. Labor force participation changes from time to time for many homemakers, students, retired and disabled persons and others. By age, those in the 16 to 19 year age group are the least likely to participate consistently in the labor force (Chart 6). The drop in their participation since early 1979 seems to have halted, the rate remaining around 54% in 1984, 1985 and 1986. There has been a very slow long-term decline in the participation rate of males 20 years of age and over, from 82.0% in 1972 to 78.3% in December, 1986. By contrast, participation by women 20 years of age and over has increased from 43.9% in 1972 to 55.1% in December, 1985 and again to 55.6 in December, 1986.

Employment and Occupations

The number of employed civilians at year-end 1986 rose by about 2.5 million (2.3%) from December 1985 to 110.6 million (Table 5). The number of executive and managerial workers was 12.9 million in 1986, up 4.7% from 12.3 million in 1985. The number of other professionals (doctors, lawyers, scientists, teachers, etc.) rose 3.7% to 14.5 million. All other administrative and service occupations, which at 80.4

TABLE 5

EMPLOYED CIVILIANS 16 YEARS AND OVER BY OCCUPATIONAL GROUPS, YEAR-END 1985 AND 1986
(In thousands, annual averages)

	1985r	1986
I. Managerial and Professional Specialty..	26,231	27,325
A. Executive/Administrative.....	8,934	9,134
B. Managerial.....	3,353	3,735
C. Professional Specialists (Total)...	13,943	14,457
a. Teachers (all levels).....	4,302	4,360
b. Health Specialists.....	2,739	2,722
c. Engineers.....	1,739	1,808
d. Scientists.....	942	1,019
e. Legal Professions (Lawyers and judges).....	655	691
f. Other Professional Specialties.	3,565	3,782
II. Technical Sales and Administrative Support.....	33,997	35,016
A. Administrative Support.....	17,595	17,833
B. Sales Occupations.....	13,036	13,853
C. Technicians and Related Support....	3,366	3,330
III. Service Occupations.....	14,787	14,886
A. Food Service.....	5,188	5,165
B. Janitorial.....	2,863	2,946
C. Health Service.....	1,798	1,821
D. Personal Service.....	2,182	2,092
E. Protective Service.....	1,800	1,872
F. Private Household Service.....	955	990
IV. Precision Production, Crafts, Repair...	13,176	13,449
V. Operatives.....	16,987	17,020
VI. Farming, Forestry and Fishing.....	2,886	2,892
Total.....	108,063	110,588

*Source: Bureau of Labor Statistics.
Note: Parts may not add to totals due to rounding.

CHART 7

EMPLOYMENT BY INDUSTRY
1965-1986
(nonagricultural payroll, quarterly average, in thousands)

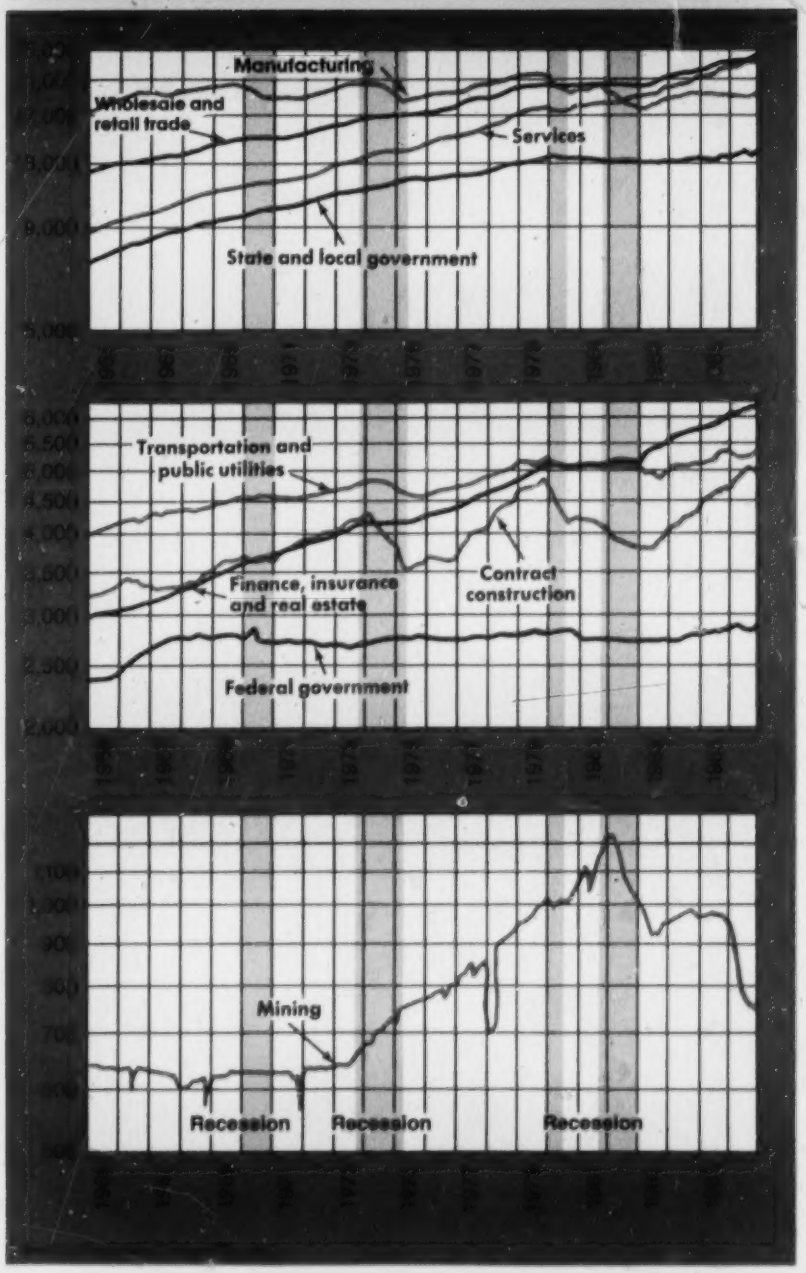


CHART 8

CIVILIAN UNEMPLOYMENT RATES BY AGE AND SEX
1960-1986
(Seasonally adjusted)

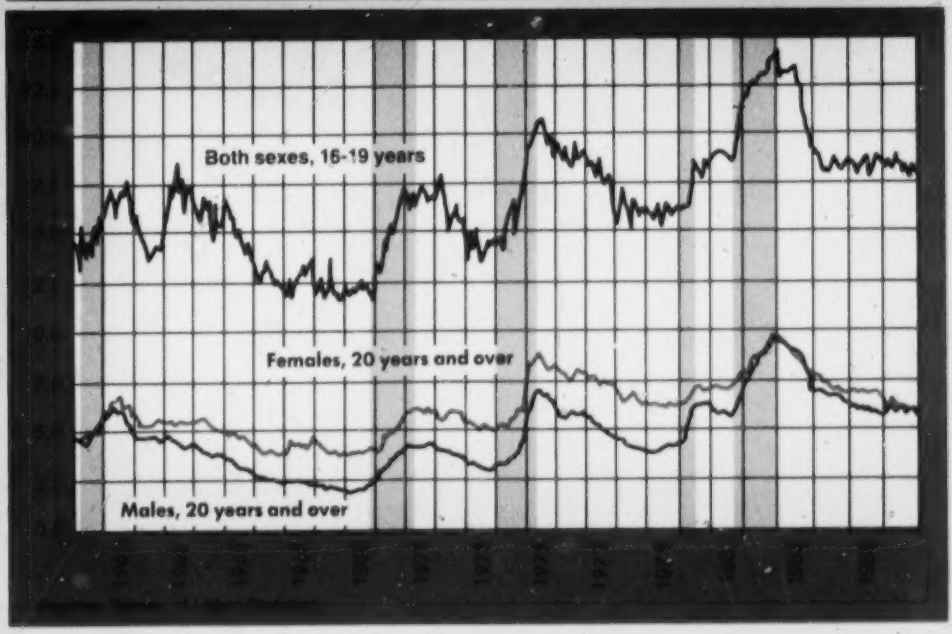


CHART 9

HELP-WANTED INDEX AND THE UNEMPLOYMENT RATE, 1975-1986
(Seasonally Adjusted)

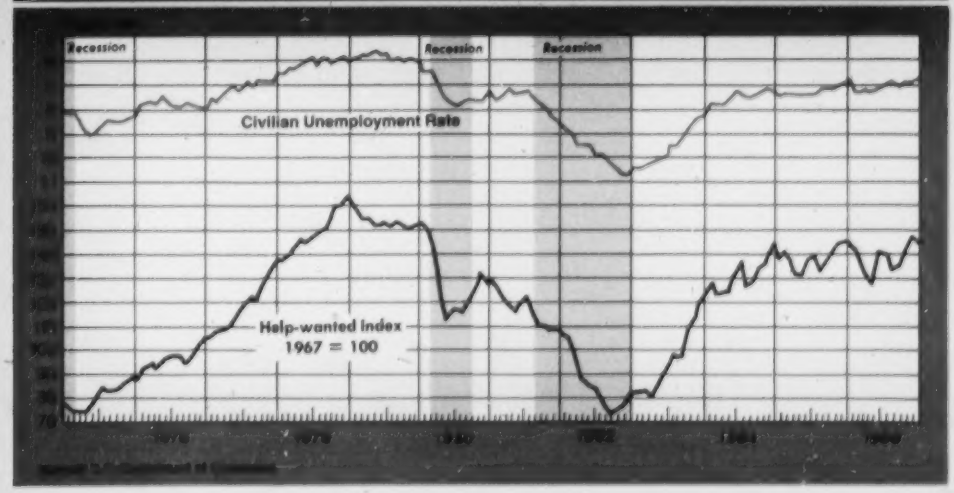
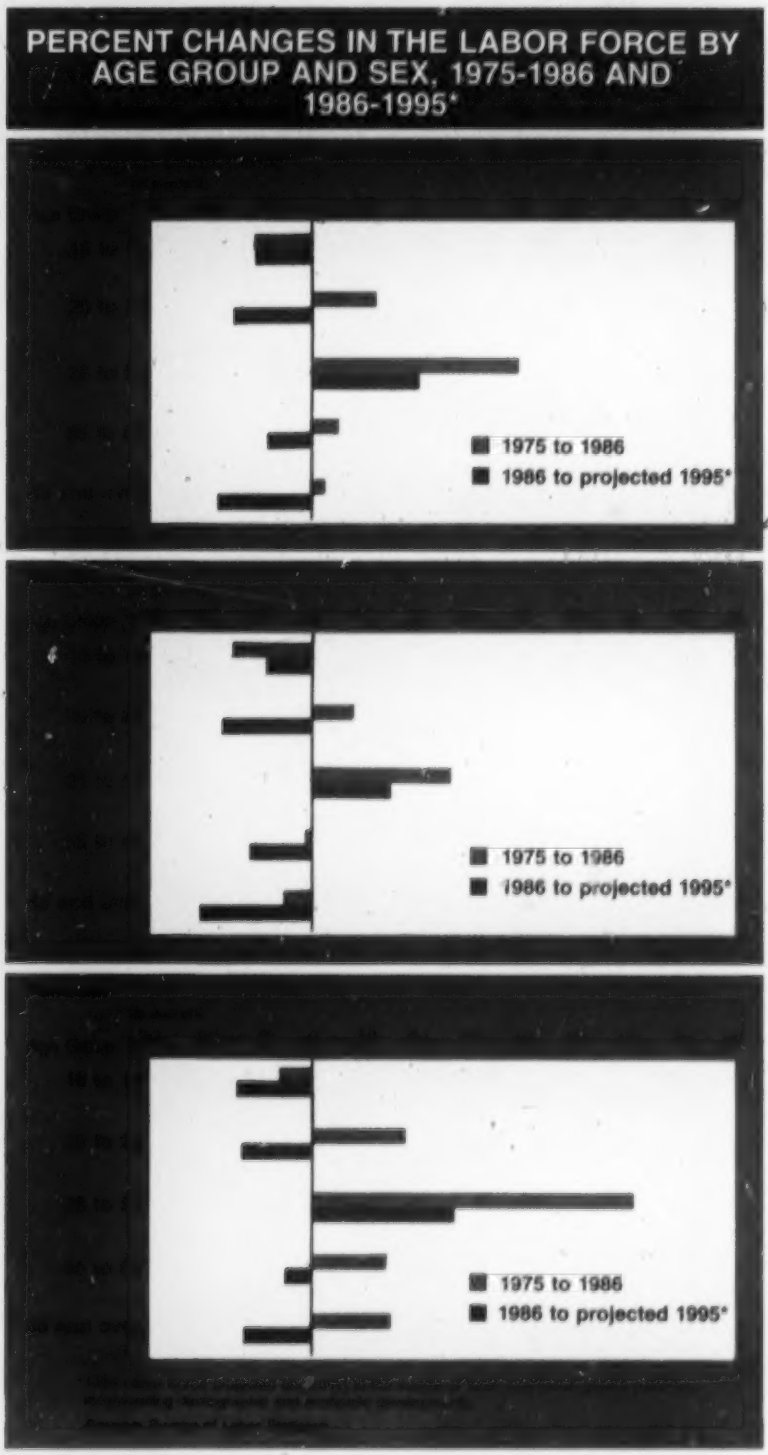


CHART 10


PERCENT CHANGES IN THE LABOR FORCE BY AGE GROUP AND SEX, 1975-1986 AND 1986-1995*
1975 to 1986
1986 to projected 1995*
1975 to 1986
1986 to projected 1995*
1975 to 1986
1986 to projected 1995*

million is the largest group of occupations, grew 1.8%. Payroll jobs in farming, forestry and fishing (operators, managers and other positions) remained stable in 1985 and 1986 at 2.9 million.

Employment by Industry

By industry, employment patterns were rather divergent during 1986. The number of jobs in the mining and manufacturing industries declined throughout the year, while government and transportation jobs grew very modestly. More rapid growth took place in services, finance and real estate, wholesale and retail trade, and construction. The small and volatile construction industry, in fact, showed the most rapid increase in employment for the year (Chart 7).

Unemployment

The civilian unemployment rate averaged 7.0% in 1986, even lower than the previous year's average of 7.2%, itself lower than the 1984 average of 7.5% and the 9.6% average of 1983. The rate for teenagers averaged 18.3%, also slightly lower than 1985's 18.6% and much lower than 22.4% in 1983 (Charts 8,9). The Help-Wanted Index, one indicator of current demand for new workers, reached its high of over 150 in 1978 (1967=100). It was at a ten-year low around 72 in 1982, and had rebounded to 83 by year-end 1982. At the end of 1984, it was approaching its previous high at 145. During 1985, the index faltered, but had regained 145 by December. During 1986, the index was variable, closing in December at 145 once more.

The Labor Force in the Future

The civilian labor force's projected growth to 129 million by 1995 will produce a rather different age distribution profile from that which developed during the 1970's and early 1980's (Chart 10). The proportion of 16-19 year olds in the labor force in 1995 will be approximately 5.5%, compared with 6.7% in 1986. The 20-24 year age group's proportion will also decline to 10.1% from 13.1%. The 25-54 year bracket will grow from 67.5% of the labor force to 74.0%. Additionally, both of the age groups over 55 will also comprise smaller proportions of the work force in the 1990's.

3

CONSUMERS AND THEIR INCOME

The Economy

The United States economy is the world's largest and provides one of the world's highest standards of living for its 242 million citizens. Generally, the size of an economy is measured in terms of its output or product, and the changes over time in this output are known as economic growth. In the United States, the Department of Commerce measures economic output and activity in the National Income and Product Accounts (NIPAs) and the Federal Reserve Board maintains the Flow of Funds Accounts (FOFs) which measure the stocks of assets and liabilities in the economy.

The National Income and Product Accounts registered Gross National Product in 1986 of well over 4 trillion dollars, or $4,206,100,000,000.00. The NIPA system divides the economy into four sectors: households, businesses, government(s) and

TABLE 6

DISTRIBUTION OF GROSS NATIONAL PRODUCT BY SECTOR, SELECTED YEARS

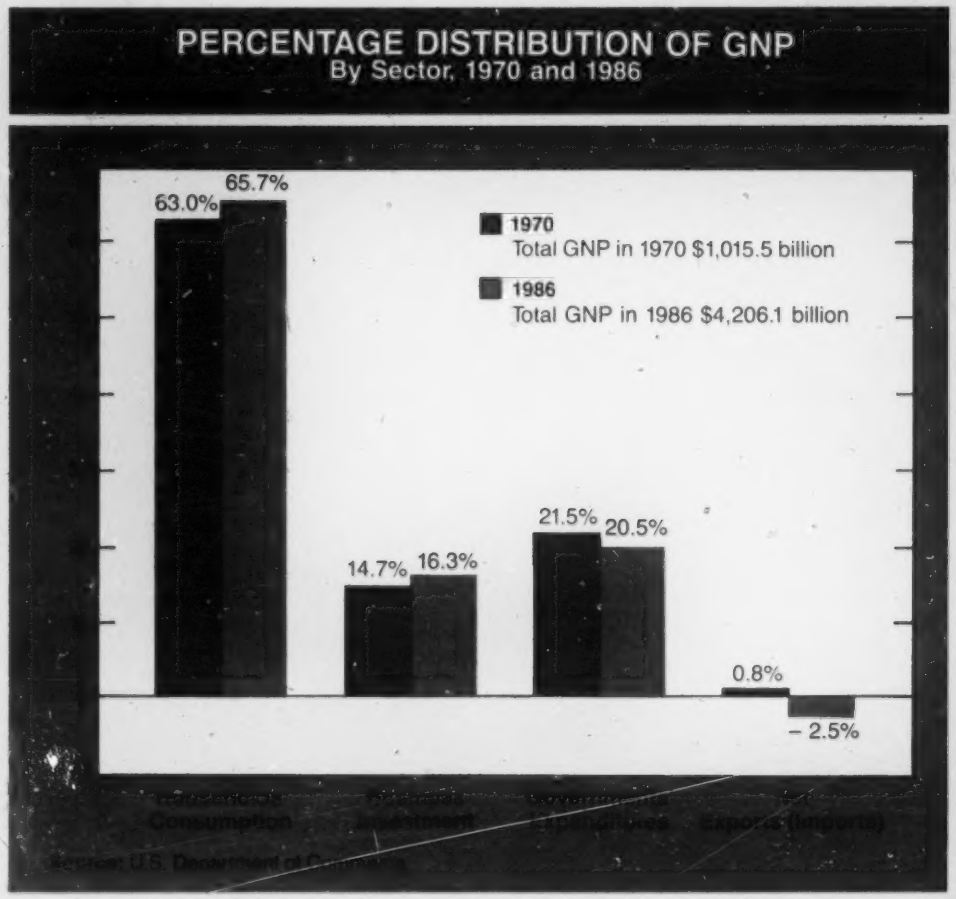
	1970	1982	1983	1984	1985	1986
HOUSEHOLDS (Personal Consumption Expenditures).....	63.0%	64.8%	65.5%	64.2%	64.7%	65.7%
BUSINESS (Gross Private Domestic Investment).....	14.7%	14.1%	14.8%	17.9%	16.8%	16.3%
GOVERNMENTS (Government Purchases of Goods and Services....	21.5%	20.3%	19.9%	19.5%	20.4%	20.5%
NET EXPORTS (Exports minus imports).....	0.8%	0.8%	-0.2%	-1.6%	-2.0%	-2.5%
TOTAL	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Gross National Product (billions).....	$1,016	$3,166	$3,402	$3,775	$3,989	$4,206.5

Source: U.S. Department of Commerce

foreign trade (usually shown as net exports). Table 6 shows the percentage distribution of GNP among the four sectors for the years 1970, 1982, 1983, 1984, 1985 and 1986 Chart 11 shows the same information for 1970 and 1986. Both show that the consumer sector accounts for about ⅗ to ⅔ of GNP. It should be noted that the effect of the foreign trade sector has been somewhat unusual in the past 4 years. Prior to 1983, the U.S. was a net exporter of goods and services, meaning that we exported more than we imported (with that item making a positive contribution to GNP in the NIPAs). For 1983, 1984, 1985 and 1986, however, the U.S. has been a net importer, showing negative net exports. Since 1984, and especially in 1986 the magnitude of the negative effect was much larger than the usual magnitude of its positive effect, suggesting the reason for growing national concern over the huge trade deficit. Certainly in 1985 the situation did not improve, as the deficit increased slightly. The trend during the year itself, however, was toward some improvement in the second and third quarters, as the dollar weakened. In 1986, however, despite a further decline in the dollar, the situation worsened, prompting Congress to press for more protectionism.

Chart 12 shows real (inflation-adjusted) GNP (in 1982 dollars) over a longer period, from 1929 to the present. Real output has grown a total of 418% in that period (a compound average rate of 2.93% per year for 57 years), and real per-capita GNP has

CHART 11



grown 161% (it was 158% in 1985). Of course, the growth did not take place at steady rates. The most marked of the fluctuations were caused by extraordinary events affecting the economy such as the Great Depression (1929-33) and the various wars (WWII, Korean, Vietnam) that had significant effects on economic activity.

Consumers and Their Income

A major driving force necessary for continuing economic growth is the income flow generated by the productivity of the economy. As we have seen, the expenditures of individuals make up a major part of GNP in the U.S., making their income characteristics important also. Wage and salary income received by individuals, income from investment in capital (in anticipation of future productivity) and as transfer payments (payments for which no service is currently rendered) from government are the major components of personal income in the U.S.

Personal Income and Its Sources

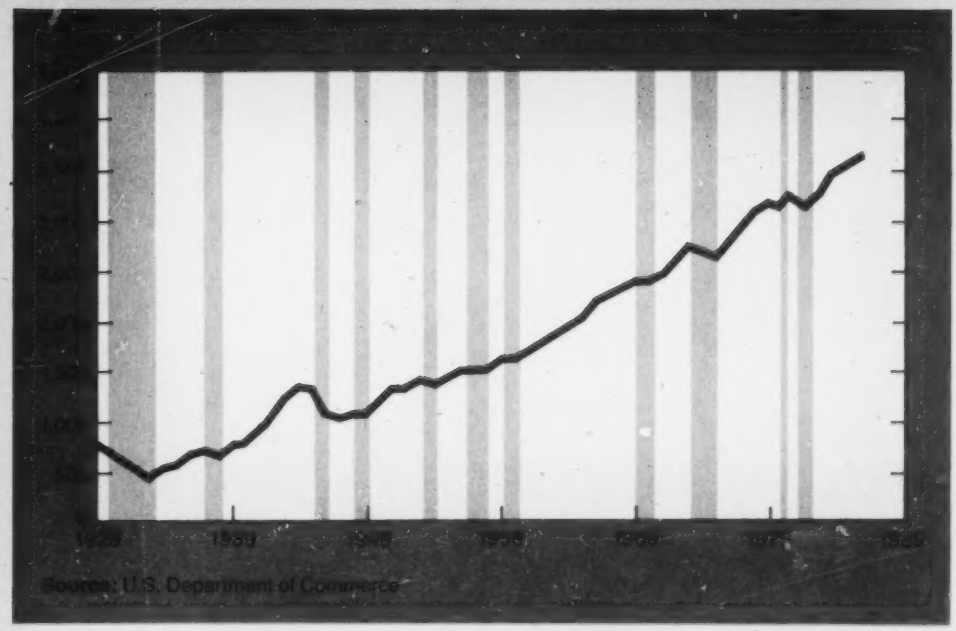
Personal income totaled $3,485.8 billion in 1986, 5.2% higher than in 1985 (Table 7). This increase was slower than that during the previous year. The only component of personal income that grew faster than in 1985 was proprietor's income, and at the same time individuals' contributions for social insurance (social security, etc.) rose slower than during 1985 but faster than did income in 1986.

In part due to the methods used to determine benefits, during the early 1980's, transfer payments (income received by individuals, generally in monetary form, and for which no services are currently rendered) had been increasing faster than had

CHART 12

REAL GROSS NATIONAL PRODUCT, 1929-1986

In billions of 1982 dollars



Source: U.S. Department of Commerce

TABLE 7

SOURCES OF PERSONAL INCOME, 1977-1986
(In billions of dollars)

Year	Wages Salaries and Related Income*	+	Proprietors' Income	+	Income from Rent, Interest and Dividends	+	Income from Transfer Payments**	-	Personal Contributions for Social Insurance	=	Effective Personal Income
1977.....	1,088.0		152.9		201.8		226.1		61.2		1,607.5
1978.....	1,227.0		176.2		234.8		244.0		69.8		1,812.4
1979.....	1,374.8		191.9		275.1		273.1		81.0		2,033.9
1980.....	1,510.4		180.7		331.4		324.7		88.6		2,258.4
1981.....	1,660.6		186.8		410.0		368.1		104.5		2,520.9
1982.....	1,749.7		175.5		447.2		410.6		112.3		2,670.8
1983.....	1,850.2		190.9		475.0		442.6		120.1		2,838.6
1984.....	2,021.3		236.9		529.0		455.6		133.5		3,110.2
1985.....	2,163.0		254.4		560.2		487.1		150.2		3,314.5
1986.....	2,282.3		278.8		571.2		513.8		160.3		3,485.8

Source: U.S. Department of Commerce.

Note: Parts may not add to totals due to rounding.

* Related income, which is called "other labor income" by the Department of Commerce, includes compensation for injuries, employer contributions under private pension and related programs, and other items such as the pay of military reservists and directors' fees.

** Transfer payments include benefit payments made under government (Federal, State and local) social security, unemployment and veterans' programs, and miscellaneous payments by business.

TABLE 8

DISPOSITION OF PERSONAL INCOME, 1977-1986
(In billions of dollars)

Year	Effective Personal Income	-	Tax and Nontax Payments	=	Disposable Personal Income	Memo: Personal Outlays	Memo: Personal Saving
1977.....	1,607.5		228.1		1,379.3	1,288.6	90.7
1978.....	1,812.4		261.1		1,551.2	1,441.1	110.2
1979.....	2,033.9		304.7		1,729.3	1,611.3	118.0
1980.....	2,258.4		340.5		1,917.9	1,781.1	136.8
1981.....	2,520.9		393.3		2,127.6	1,968.1	159.4
1982.....	2,670.8		409.3		2,261.4	2,107.5	153.9
1983.....	2,838.6		410.5		2,428.1	2,297.4	130.6
1984.....	3,110.2		439.6		2,670.6	2,501.9	168.7
1985.....	3,314.5		486.5		2,828.0	2,684.7	143.3
1986.....	3,485.7		514.1		2,971.6	2,857.4	114.2

Source: U.S. Department of Commerce.

Note: Parts may not add to totals due to rounding.

income received by current producers. This imbalance caused some problems for governments (which are generally the parties making these payments), especially at the federal level. Liberalized social security, veterans', and government pension and welfare benefits accounted for most of these rises. The increases have also been accentuated by the tying of automatic social security and government pension benefit raises to increases in the consumer price index. This tying arrangement has contributed to the difficulties in controlling the federal government's so-called "entitlements programs" and in turn in controlling that portion of its massive deficit. The imbalance improved in 1984, as income from production outpaced transfer payments, but the earlier pattern returned in 1985 and 1986. As a result, transfer payments as a portion of personal income remained unchanged from 1985 at 14.7%. This compares with levels around 11% in the early 1970's.

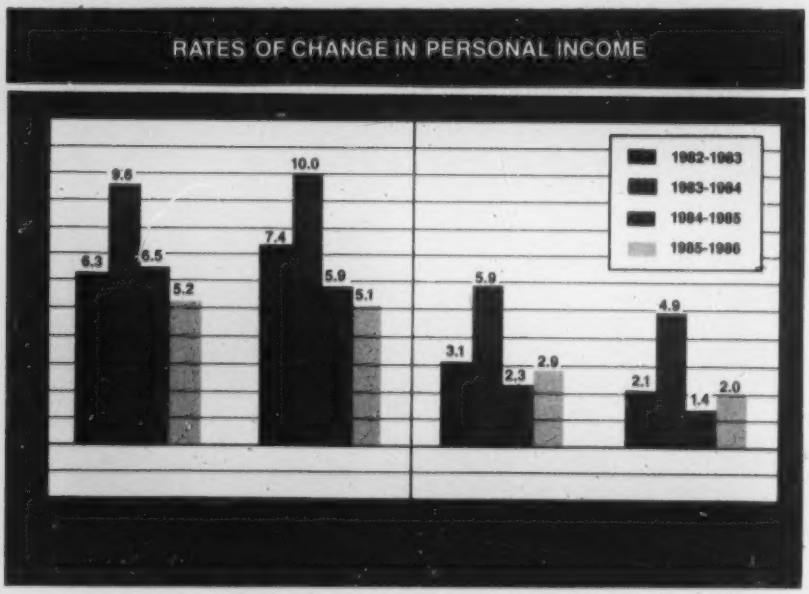
Disposable Income

More important in determining consumers' expenditures than total personal income is the amount of income over which individuals have discretion; specifically their income after taxes and other required payments to government. Personal tax and nontax payments for the year 1986 at $514.1 billion were 14.7% of total personal income (Table 8), the ratio being up from 1983 and 1984, but still lower than in 1981, 1982 and 1985. Remaining after taxes in 1986 was disposable personal income of $2,971.6 billion, up 5.1%.

Real Income

One of the most frequently used measurements of the effect of price increases on income uses the Department of Commerce's price deflators to determine real income based on 1982 price levels. The derived rates of increase in personal income are shown in Chart 13. While total personal income in 1986 rose 5.2% and income after taxes rose 5.1% in current dollars, when adjusted for price changes by the personal consumption expenditures deflator, the rise in disposable personal income in 1986 was just 2.9%. When account is taken of population changes, 1986 real per capita disposable personal income at $10,752 (in 1982 dollars) was 1.7% higher than the $10,577 in 1985. A more general 1986 study by the Census Bureau determined that Americans

CHART 13



have increased their standard of living on average by about 20% each decade since 1940.

Households and Families

The Census Bureau defines a household as "all of the persons who occupy a house, an apartment, or other group of rooms, or a room which constitutes a housing unit," whereas a family is defined as "a group of two or more persons related by blood, marriage or adoption and residing together." A family is thus essentially a sociological unit, whereas a household is an economic unit. It is the economic entity which is most often the primary unit of consumption for goods and services, especially housing, household services, consumer durables, and also frequently for food.

Household Income

Median household income (before tax and nontax payments) in the United States was $23,618 in 1985. Mean household income was $29,066 (Table 9).

As shown in Chart 14, household income tends to rise until the householder ("head of household") reaches late middle age, and to decline thereafter. Mean income in 1985 ranged from $17,708 for households in which the head was under 25 years of age to $38,316 for households headed by a person between 45 and 54 years of age, back down to only $18,800 for households in which the householder was 65 years of age or older (and most often retired).

Income also varies closely with education of the householder. The largest single educational group is that in which the householder has completed high school but gone no further in school. In 1985, this group comprised about 35.4% of all households; mean income was $26,462, just below the overall household average. At one extreme, where the householder had completed 4 or more years of college, 20.9% of the households had mean income of 160% of the average for all households. At the other extreme, where the householder had com-

CHART 14

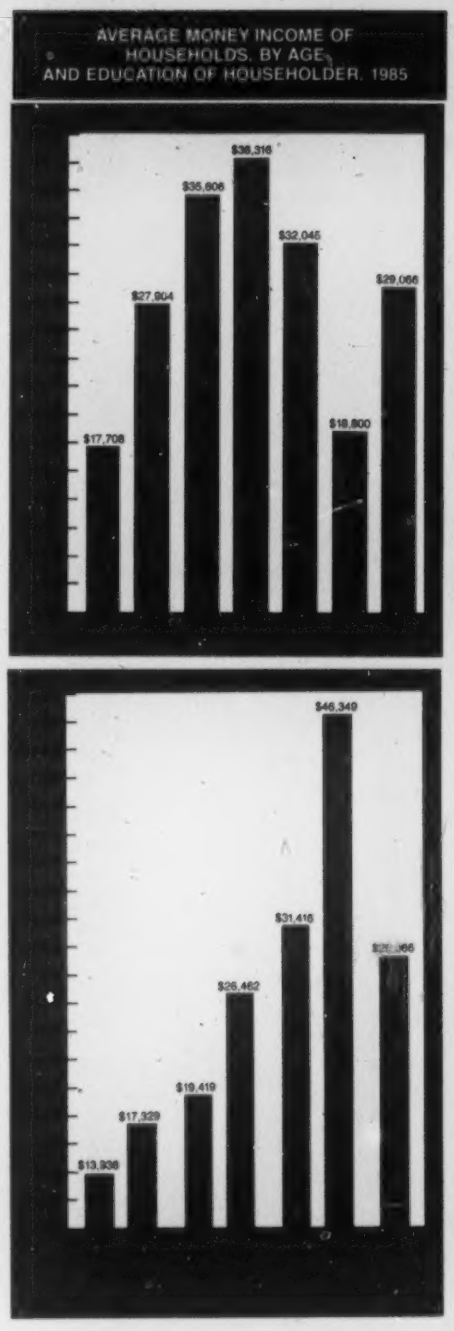


TABLE 9

SELECTED INCOME CHARACTERISTICS OF HOUSEHOLDS – 1985*

	Thousands of Households	Mean Household Income	Group's Share of Aggregate Income
All Households.....	88,458	$29,066	100.0%
Type of Household			
Male Householder.....	61,038	$33,720	80.1%
Female Householder...	27,420	$18,706	19.9%
Number in Household			
One.....	21,170	$15,997	13.2%
Two.....	27,732	$29,525	31.8%
Three.....	16,088	$34,300	21.5%
Four.....	13,774	$37,161	19.9%
Five.or more.....	9,694	$36,122	13.6%
Type of Residence			
Nonfarm.....	86,653	$29,169	98.5%
Farm.....	1,805	$24,119	1.5%
Inside metropolitan area	68,363	$31,031	82.7%
Outside metropolitan area	20,094	$22,383	17.3%
Owner occupied	56,408	$34,066	74.7%
Renter occupied	32,060	$20,266	25.3%
Region			
Northeast.....	18,562	$31,146	22.5%
Midwest.....	21,847	$28,149	23.9%
South.....	30,311	$27,044	31.9%
West.....	17,738	$31,475	21.7%

Source: Bureau of the Census, AFSA

Note: Parts may not add to totals due to rounding.

* As of March 1986.

TABLE 10

DISTRIBUTION OF FAMILIES AND UNRELATED INDIVIDUALS BY TOTAL MONEY INCOME IN 1985

Total Money Income	Families Thousands	Percent
Under $5,000.....	3,060	4.8%
$5,000 to $9,999.....	5,429	8.6%
$10,000 to $14,999...	6,495	10.2%
$15,000 to $19,999...	6,671	10.5%
$20,000 to $29,999...	12,739	20.0%
$30,000 to $39,999...	10,451	16.4%
$40,000 to $49,999...	7,096	11.2%
$50,000 to $59,999...	4,570	7.2%
$60,000 to $74,999...	3,523	5.5%
$75,000 and over.....	3,525	5.5%
Total.....	63,558	100.0%
Median Income.....	$27,735	
Mean Income.....	$32,944	

Total Money Income	Unrelated Individuals Thousands	Percent
Under $5,000.....	6,002	19.1%
$5,000 to $9,999.....	7,474	23.8%
$10,000 to $14,999...	5,240	16.7%
$15,000 to $19,999...	4,025	12.8%
$20,000 to $29,999...	4,853	15.5%
$30,000 to $34,999...	1,339	4.3%
$35,000 to $49,999...	1,574	5.0%
$50,000 and over.....	844	2.7%
Total.....	31,351	100.0%
Median Income.....	$11,808	
Mean Income.....	$15,504	

Source: Bureau of the Census.

Note: Parts may not add to totals due to rounding.

*As of March, 1986.

pleted less than 8 years of school, 7.5% of the households, had mean income of only 48% of that for all households.

Other household characteristics that vary with average income, such as the number of persons in the household, type of residence, and region of the country are detailed in Table 9.

Family Income

The Census Bureau estimates that there were 63.6 million families in the United States in 1985 (Table 10). This compares with the estimated 88.5 million "households" referred to above.

Average family income, not surprisingly, tends to be higher than average household income, since households include various unrelated individuals in the base used to calculate the average(s). The median income of all families in the United States was $27,735 in 1985 and the mean was $32,944.

There have been in recent years gradual but widespread changes in family structure which have tended to exert a downward pressure on family income levels. Most significantly there has been a substantial increase in the proportion of families maintained by a female householder (from 1970 to 1986, for example, the percentage rose from around 10% to 16%). In fact, 33% of the increase in family households between 1980 and 1986 is attributable to families maintained by women. Since median incomes in this group are by far the lowest of all family types, growth in this group would exert a downward pressure on the overall average. The 1980's have also witnessed a sharp increase in the poverty rate for persons, from 11.4% in 1978 to 15.2% in 1983. The 1984 rate, however, declined to 14.4% followed by another decline in 1985 to 14.0%.

4

DISPOSITION OF PERSONAL INCOME: CONSUMERS' SPENDING AND CAPITAL FORMATION

The spending decisions of consumers largely determine both the level and composition of U.S. economic output. One way of measuring this output, in fact the method used in the National Income and Product Accounts (NIPAs), calculates the total amount of final expenditures in the economy. By this measure, the gross national product, the value of goods and services produced, was $4,206.5 billion in 1986 (Table 11). As seen earlier (Chart 11), of the total GNP personal consumption expenditures amounted to around 66%.

The disposition of personal income is detailed in Chart 15 and in Table 12. Individuals' income is disposed of in three broad categories. Some portion automatically goes for taxes; in 1985 this portion constituted 14.7% of income ($514.1 billion). A large part is spent out-of-pocket for consumption and other purposes, the whole of which is known as personal outlays. The remainder is saved in various forms.

Personal Outlays

Personal outlays (defined by the Department of Commerce as including personal consumption expenditures, interest payments by individuals and transfers abroad by individuals) rose nearly proportionately with disposable personal income during the 1960's. During recessions or pauses in growth when durable goods spending is greatly reduced, consumer outlays tend to drop off as a percent of disposable income and to increase again during strong recovery periods. Personal outlays as a portion of disposable personal income since 1970 have varied between 90.6% (1973) and 96.2%, a new high reached in 1986 as the economy experienced the fourth full year of recovery.

Personal Consumption

Personal consumption expenditures, a portion of personal outlays, are that part of individuals' outlays that go for current purchase or consumption of goods and services (interest paid to business is here not considered purchase of a service). All current expenditures for food, clothing, rent, entertainment, travel, education and the like are considered personal consumption expenditures. In 1986, 96.7% of personal outlays were for personal consumption. The 7% increase in this sector was a major force in the continued growth during the year. Of the total, expenditures for durable goods comprised about 14%, unchanged from the year before. Expenditures for nondurables

comprised about 33.8% of consumption spending. Expenditures for services, by growing faster than total consumption, also grew as a share of that total, to 52.2%. Retail auto sales, a major component of consumer durables, rose to about 11.5 million units in 1986, up 4% from 1985. Even with the low-rate financing incentive plans offered by domestic auto finance companies, sales of domestic cars remained stable while sales of imports which made up over 28% of retail sales decreased at 14%. Sales of domestic cars have decreased as a portion of total sales from 74.3% in 1985 to 71.7% in 1986. The Census Bureau in a 1986 study revealed more about the consumption habits of the American people. Among others, it found that more than 40% of households own at least two automobiles, up from 15% 25 years ago, that Americans are spending almost five times the amount per person for recreation than in the 1920's, and that four times as many people travel overseas each year (12 million) as did in the early 60's.

Personal Saving

For all sectors, the portion of income neither paid in taxes nor spent ("outlayed") constitutes saving. Since 1970, saving in

TABLE 11

GROSS NATIONAL PRODUCT, BY SECTOR, 1977-1986

		Personal Consumption Expenditures						
	Total GNP	Durable Goods	Non-durable Goods	Services	Total	Govern-ment Purchases	Private Domestic Investment	Net Exports
			(Billions of current dollars)					
1977	1,990.5	184.5	490.4	582.3	1,257.2	387.3	344.1	1.9
1978	2,249.7	205.6	541.8	656.1	1,403.5	425.2	416.8	4.1
1979	2,508.2	219.0	613.2	734.6	1,566.8	467.8	454.8	18.8
1980	2,732.0	219.3	681.4	831.9	1,732.6	530.3	437.0	32.1
1981	3,052.6	239.9	740.6	934.7	1,915.1	588.1	515.5	33.9
1982	3,166.0	252.7	771.0	1,027.0	2,050.7	641.7	447.3	26.3
1983	3,405.7	289.1	816.7	1,128.7	2,234.5	675.0	502.3	-6.1
1984	3,765.0	331.2	870.1	905.1	2,428.2	733.4	662.1	-58.7
1985	3,998.1	359.3	905.1	1,336.1	2,600.5	815.4	661.1	-78.9
1986	4,206.5	388.4	932.7	1442.0	2,763.1	864.5	684.1	-105.2
			(Billions of constant 1982 dollars)					
1977	2,958.6	253.9	828.0	898.5	1,883.8	589.1	521.3	-35.5
1978	3,115.2	267.4	800.7	939.8	1,961.0	604.1	576.9	-26.8
1979	3,192.4	266.5	771.0	971.2	2,004.4	609.1	575.2	3.6
1980	3,187.1	245.9	764.4	991.9	2,000.4	620.5	509.3	57.0
1981	3,248.8	250.8	762.6	1,009.0	2,024.2	629.7	545.5	49.4
1982	3,166.0	252.7	766.6	1,027.0	2,050.7	641.7	447.3	26.3
1983	3,279.1	283.1	800.2	1,062.7	2,146.0	649.0	504.0	-19.9
1984	3,489.9	318.9	828.6	1,098.7	2,246.3	675.2	652.0	-83.6
1985	3,585.2	343.9	841.6	1,139.0	2,324.5	721.2	647.7	-108.2
1986	3,675.5	368.9	872.1	1,178.2	2,419.1	747.0	657.9	-148.6

Source: U.S. Department of Commerce.

Note: Parts may not add to totals due to rounding.

the consumer sector has ranged from as much as 9.4% of disposable personal income (in 1973) to as little as 3.8%, a new low reached in 1986. Individuals saved a total of $114.2 billion in 1986, 11.5% less than the $129 billion saved in 1985.

Consumer Prices

One factor that influences consumers'

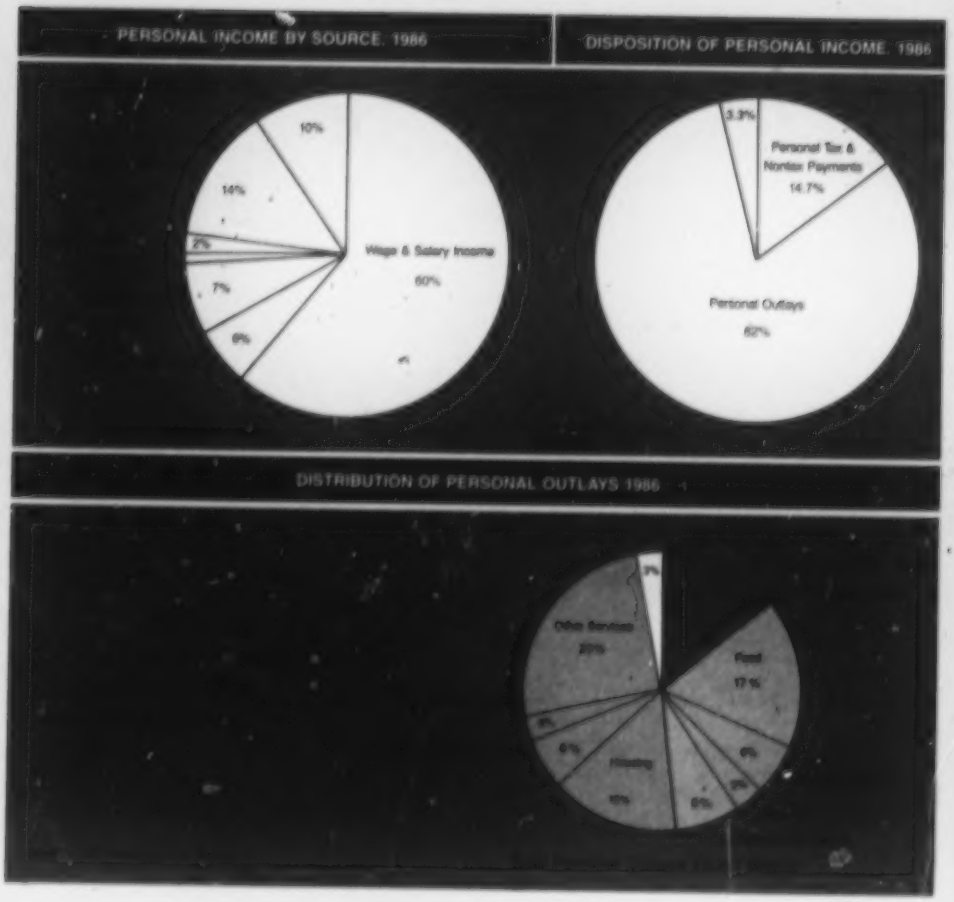
TABLE 12

PERSONAL INCOME AND ITS DISPOSITION, 1986
(In billions of dollars)

TOTAL PERSONAL INCOME	$3,485.7
Wages and Salary	2,073.5
Other Labor Income	208.8
Proprietors' Income	278.8
Rental Income	15.0
Dividend Income	81.2
Interest Income	475.0
Net Transfer Payments	353.5
DISPOSITION OF PERSONAL INCOME	
Personal Tax & Nontax Payments	514.1
Personal Outlays	2,857.4
Personal Consumption Expenditures	2,762.5
Durable Goods	388.1
Autos & Parts	182.0
Furniture, Household Goods	137.2
Other Durables	69.0
Nondurable Goods	932.7
Food	492.6
Clothing and Shoes	165.0
Gas & Oil	78.6
Other Nondurables	196.5
Services	1,441.7
Housing	438.4
Household operation	178.6
Transportation	95.9
Other Services	728.8
Interest paid to business	93.5
Personal transfer payments abroad	1.4
Personal Saving	114.2

Source: Department of Commerce.

CHART 15



levels and patterns of spending is the prices of the goods that they purchase. The most common measure of general price levels for consumer goods is the Consumer Price Index, which is maintained by the Department of Labor. The index measures the current price of a consistent "basket" of goods over time, showing the overall price level as a percent of the price for the same goods in a base year. The CPI uses 1967 as its base year. Table 13 shows the annual average of the monthly index for urban consumers from 1970 to 1986, as well as the percent increase in the index from the end of one year to the next. The index increased in 1986 only by 1.9%, less than it had in any single year since 1970. In fact, the annual increases in the past four years have all been at or below 4%, well clear of the double-digit increases that wreaked such havoc in the late 1970's. Of course, it is important to realize that, just as price levels can influence consumer spending, the reverse is true i.e., that changes in spending (demand) due to factors other than the prices, can also lead to price changes.

Measuring Consumer Behavior

The importance of the consumer sector in overall economic activity, with consumers accounting for about ⅔ of GNP, has given rise to the development of indicators designed to measure with precision various

TABLE 13

CONSUMER PRICE INDEX FOR URBAN CONSUMERS (CPI-U)
(1967 = 100)

	Individual (annual averages)	December to December Change
1970	116.3	5.5%
1971	121.3	3.4%
1972	125.3	3.4%
1973	133.1	8.8%
1974	147.7	12.3%
1975	161.2	7.1%
1976	170.5	4.9%
1977	181.5	6.8%
1978	195.4	9.0%
1979	217.4	13.2%
1980	246.8	12.4%
1981	272.4	8.9%
1982	289.1	3.9%
1983	298.4	3.8%
1984	311.1	4.0%
1985	322.2	3.7%
1986	328.4	1.9%

Source: Bureau of Labor Statistics

characteristics of the consumer sector. With the aid of such indicators to measure changing consumer attitudes toward goods, services, credit, financial security, and changing family needs and values, these less tangible aspects of the consumer sector can be better followed and understood.

The University of Michigan's Consumer Sentiment Index is one such indicator. Chart 16 shows the index (plotted quarterly prior to 1978 and monthly thereafter) from 1972 through 1986. This index has tended to decline prior to previous downturns in the business cycle, and therefore may be useful in loosely predicting the future course of the economy. The index slipped late in 1986 (89.1 in December) after rather good showings in the middle of the year (99.3 in June). The index has really been following a sideways movement since 1983, a reflection of the cautious optimism regarding the economy in general.

Other indexes of Consumer Financial Behavior, developed by the American Financial Services Association, highlight recent trends in consumer income and its uses (Chart 17).

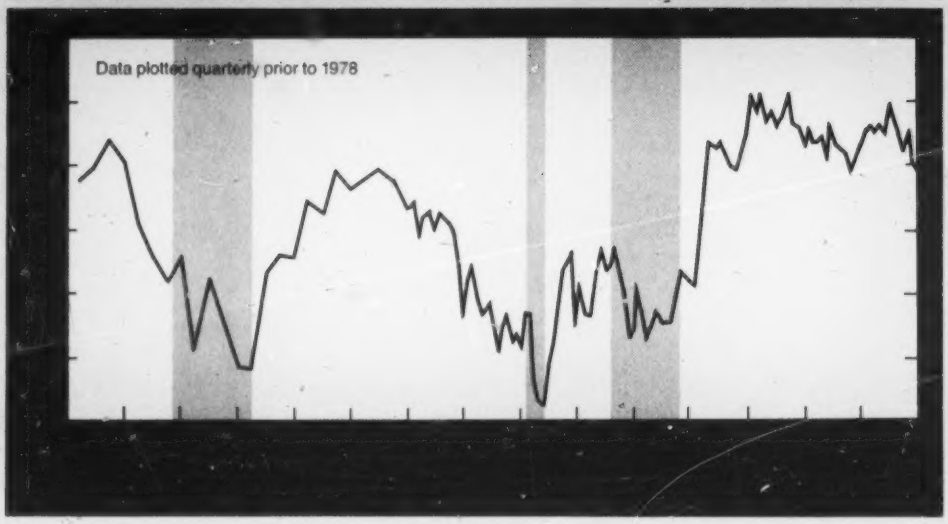
The indexes reveal personal income at 132% of its 1982 level in the last quarter of 1986, personal taxes at 131%, disposable income at 132% (keeping pace with total personal income) and personal saving at a very low 48%. The indexes for consumer expenditures were: durables, 160%; nondurables, 122%; and services, 144%. The index for consumer installment credit grew rapidly in 1986, and the index reached 181% by the end of the year.

Consumers as Capitalists

To the extent that they provide a large portion of the funds borrowed by commer-

CHART 16

CONSUMER SENTIMENT INDEX
By Months



cial enterprises (through their saving and investment), consumers have become capitalists in the economic sense. In addition to their ownership of the means of production in the form of corporate stocks and bonds, they generally own the physical capital which is productive in that it satisfies their own needs for living quarters, transportation, household services and the like. (In 1984 almost 65% of all households owned the home in which they lived.)

Capital Formation

Capital formation (in physical terms) may be defined as the addition of property and goods that promote the production of other goods and services. In this sense, owner-occupied houses and durable goods purchased by consumers are similar in nature to investment by businesses. Net capital formation (capital formation after allowing for concurrent "consumption" of capital) as estimated in the Flow of Funds accounts in 1986 was $342.5 billion (Table 14). Net capital formation by business approximated $122 billion and by consumers $220 billion—$106 billion for housing and $114 billion for other durables. Thus, consumers' contribution to capital formation carried net capital formation higher in 1986 than in 1985 despite a $10 billion drop in business' net spending.

In order to purchase capital items (homes, automobiles, television sets, refrigerators and other consumer durables) which require a large initial outlay, consumers as well as businesses often borrow, or "finance" such purchases, in order to pay over some period of time as they "consume" the services produced by the item. Thus, just as a corporation sells debentures to finance the purchase of goods-producing machines and just as the local school district may float a bond issue to build a school, consumers, in a similar manner, borrow to finance the purchase of capital goods. When financing this way, the corporation commits part of its future earnings to repayment of the debentures, the school district commits part of its future tax receipts to repayment of the bond issue,

TABLE 14

CAPITAL FORMATION, 1981-1986
(In billions of dollars, seasonally adjusted annual rates)

	1981	1982	1983	1984	1985	1986
Gross Capital Formation.....	755.4	700.0	791.4	993.3	1,020.4	1,072.5
Business (Gross domestic investment minus household purchases of residences).	409.1	362.0	383.5	513.9	505.2	510.5
Consumer.....	346.3	338.0	407.9	479.4	515.2	562.0
Housing (Household purchases of residence and condominiums).....	106.4	85.3	118.8	148.2	155.9	173.6
Durables.....	239.9	252.7	289.1	331.2	359.3	388.4
Capital Consumption Allowances	550.4	598.6	623.0	653.6	693.6	730.0
Business (Capital consumption minus owner occupied homes)..	296.4	328.9	339.6	355.2	373.3	388.2
Consumer.....	253.9	269.7	283.4	298.4	320.3	341.8
Housing.....	51.4	54.3	57.0	59.9	64.0	67.0
Durables.....	202.5	215.4	226.4	238.5	256.3	274.8
Net Capital Formation.....	205.0	101.4	168.4	339.7	326.8	342.5
Business.....	112.7	33.1	43.9	158.7	131.9	122.3
Consumer.....	92.4	68.3	124.5	181.0	194.9	220.2
Housing.....	55.0	31.0	61.8	88.3	91.9	106.6
Durables.....	37.4	37.3	62.7	92.7	103.0	113.6

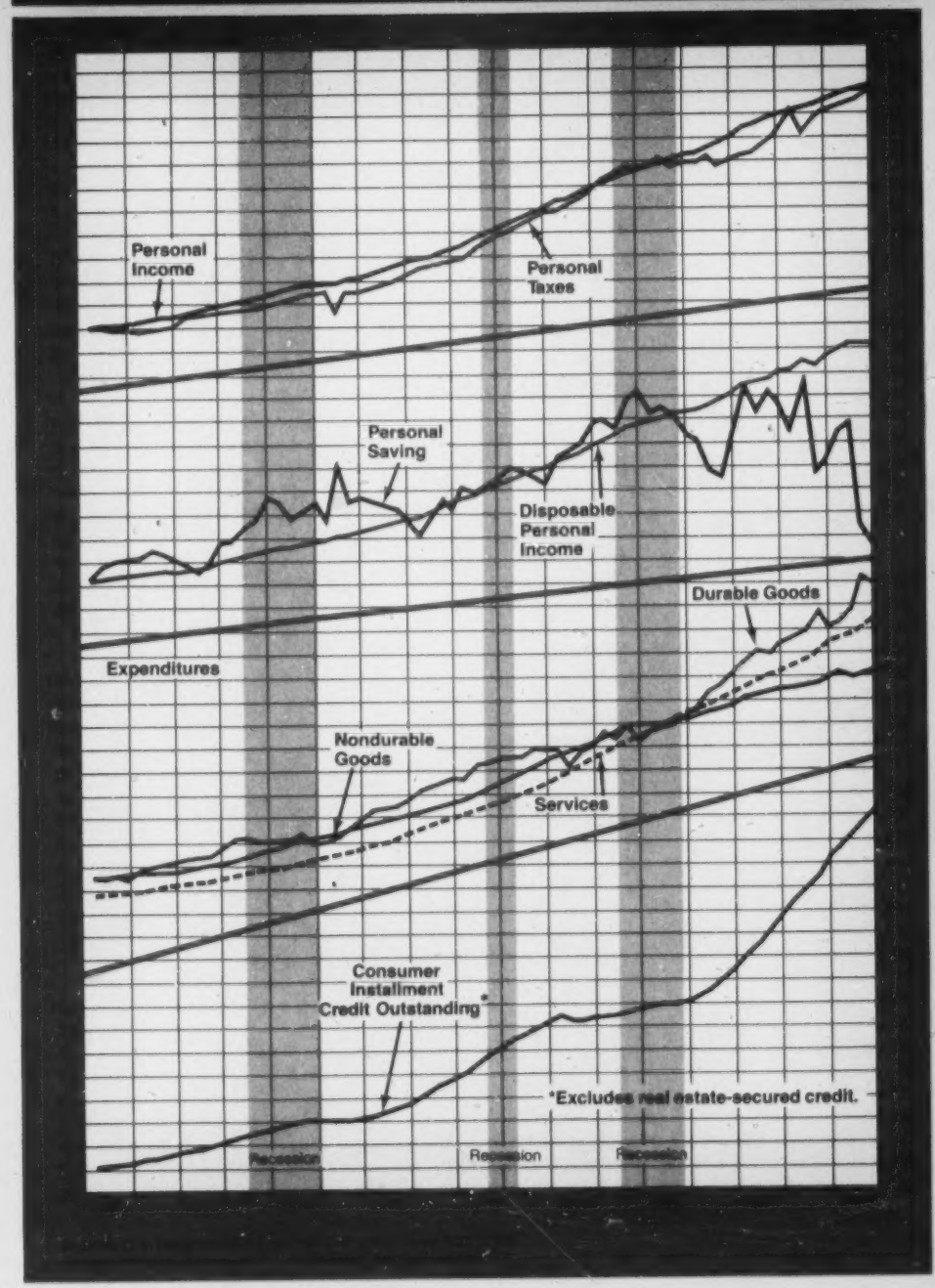
Source: Federal Reserve Flow of Funds Accounts Series.
Note: Parts may not add to totals due to rounding.

and the consumer commits part of his or her future income to repayment of a mortgage (when financing a home) or to repayment of installment credit (when borrowing for other purposes). The financial markets provide the mechanism for making funds available, by collecting savings which are then loaned out in financing such investment.

CHART 17

INDEXES OF CONSUMER FINANCIAL BEHAVIOR

Plotted Quarterly



5

CONSUMERS' ASSETS AND LIABILITIES: CONSUMERS AS FINANCERS

By virtue of the widely distributed discretionary spending power of consumers in the United States, this group, through its spending, saving and investing decisions, plays a significant role in determining the course and level of future economic activity in this country. Consumers' spending constitutes the largest portion of the demand for the output of this economy, as we have already seen. Through their saving and investment habits, consumers in the aggregate also provide a share of the funds borrowed by businesses to engage in production, and a good portion of the funds borrowed by governments as well. In addition, consumers finance government (although not at their own discretion) via taxes and contributions to social insurance funds (most notably the various Social Security programs).

In 1986, individuals were taxed and made payments to social insurance funds as required by law at a rate of 19.3% of their total income. This ratio declined from 19.5% in 1985 (Table 15). Taxes paid by individuals in 1986 of $514 billion in nominal dollars were 5.7% more than taxes paid in 1985. This increase was about the same as that in income, keeping the portion of income paid in taxes to almost 15%. Individuals' payments to social insurance funds also increased faster than did incomes, rising from $150 billion in 1985 to $160 billion in 1986, a 6.7% increase.

The Flow of Funds Accounts maintained by the Federal Reserve Board may be used to show the role played by various sectors in overall saving and investment in the economy. The consumer sector is represented in the Flow of Funds accounts as "households" and in this context the two terms will be used interchangeably. The household sector in the Flow of Funds series includes not only households but also nonprofit organizations serving individuals such as foundations, private schools and hospitals, labor unions, and charitable, welfare and religious organizations. The effect of the inclusion of these organizations is minor, however, as their combined size is a tiny fraction of the whole.

The household sector's net saving in 1986 amounted to $308 billion, a decline of 3% over the year. The decline was due mostly to a 20% decline in personal saving (Table 16). A 10% increase in net durables in consumption and a more than doubling of capital gains dividends counteracted the decline, however. Adding consumption of capital to net saving, gross saving increased slightly to $663 billion, following a 1.3% increase the prior year.

Households' total investment was larger in 1986 than in 1985, by just 1.4%. Gross investment of $723 billion consisted of $581 billion in expenditures on capital goods and $142 billion in net financial

TABLE 15

FINANCING OF GOVERNMENT BY INDIVIDUALS 1981-1986
(In billions of dollars except as indicated by percent)

	1981	1982	1983	1984	1985	1986
Total Government Receipts....	977.2	1,000.8	1,061.3	1,173.7	1,265.4	1,342.1
Received from individuals..	497.8	521.6	530.6	573.1	636.7	674.4
Percent of total.....	50.9%	52.1%	50.0%	48.8%	50.3%	50.2%
Federal.....	639.5	635.3	659.9	726.5	786.8	826.9%
State and Local.....	337.7	365.5	401.5	447.2	478.5	515.3
By Source:						
Tax and Nontax Receipts....	725.9	731.2	770.3	847.0	909.7	966.1
Received from individuals..	393.3	409.3	410.5	439.6	486.5	514.1
Percent of total.....	53.8%	56.0%	53.3%	51.9%	53.5%	53.2%
Social Insurance Fund Contributions.....	251.3	269.6	291.0	326.7	355.7	376.0
Received from individuals..	104.5	112.3	120.1	133.5	150.2	160.3
Percent of total.....	44.1%	41.7%	41.3%	40.9%	42.2%	42.6%
Memo:						
Total Personal Income.....	2,520.9	2,670.8	2,838.6	3,110.2	3,314.5	3,485.7
Percent paid to government for:						
Taxes, etc.....	15.6%	15.3%	14.5%	14.1%	14.7%	14.7%
Social insurance funds	4.1%	4.2%	4.2%	4.3%	6.5%	6.6%
Total.....	19.7%	19.5%	18.7%	18.4%	19.2%	19.3%

Source: Department of Commerce.

Note: Parts may not add to totals due to rounding.
* Less Federal grants-in-aid to state and local governments.

investment.

The funds made available through households' net saving and financial investment might be termed their "discretionary" funding of government and business, in contrast to their nondiscretionary financing of government through taxes.

Consumers as Debtors

Concurrent with their accumulation of assets, both real and financial, consumers as a group are also borrowers. Consumers' debt has been declining from over 32% of total credit market debt outstanding in the past several years. In 1986, households owed 29.2% of total credit market debt, or $2,657 billion (Table 17). Consumer debt increased faster than other debt during the 1950's. During late 1960's and early 1970's the debt of private business generally rose much faster than that of consumers or government. In 1986, the household sector's debt rose 12% over its 1985 level, lower than the 14% increase that occurred during 1985. Business and overall government debt increased 12% and 16.3% respectively. The smaller state and local government debt

TABLE 16

SAVING AND INVESTMENT BY HOUSEHOLDS, 1981-1986
(In billions of dollars, seasonally adjusted annual rates)

	1981	1982	1983	1984	1985	1986
Gross Saving.....	503.0	517.7	545.9	641.7	650.3	668.1
Net saving.....	239.2	237.4	251.2	331.3	317.6	313.1
Personal saving.....	159.4	154.0	130.6	168.7	143.3	114.2
Credit from government insurance.....	39.7	43.9	53.5	63.9	66.5	68.1
Capital gains dividends	2.7	2.4	4.4	6.0	4.9	17.5
Net durables in consumption....	37.4	37.2	62.7	92.7	102.9	113.3
Capital consumption....	263.7	280.3	294.7	310.4	332.8	355.0
Gross investment.....	565.0	610.7	606.1	732.0	712.8	723.6
Capital expenditures (homes, durables, etc)	362.0	355.0	427.8	500.2	535.3	581.0
Net financial investment	202.9	255.7	178.2	231.8	177.4	142.6
Net acquisition of financial assets.....	327.1	351.1	377.0	469.0	490.1	434.6
Less net increase in liabilities.....	124.2	95.3	198.7	237.2	312.7	292.0
Discrepancy (Saving-Investment)....	-62.0	-93.0	-60.2	-90.3	-62.5	-55.5

Source: Federal Reserve Board.
Note: Parts may not add to totals due to rounding.

aggregate grew at almost the same rate (12%) as did the federal government debt (13.4%).

Consumers' Assets and Liabilities

Combining consumers' liabilities and assets, both real and financial, makes it possible to look at the "balance sheet position" of American households (Chart 18). Total financial assets of $11,205 billion and tangible assets of $5,601 billion brought total assets of the sector to almost $17 trillion. Tangible assets included the value of owner-occupied housing, the land on which it stands, and the value of durable goods. Credit market debt (as discussed above) combined with other miscellaneous liabilities adds to total liabilities of $2.76 trillion (Table 18).

Subtracting liabilities from assets yields the net worth, or wealth of the household sector. In 1986, household net worth was estimated at $14,049 billion, up 9.1% from 1985. Liabilities again increased at a faster rate than did assets (12% vs 9.6%) causing various ratios of assets to liabilities to fall slightly (Table 19).

TABLE 17

TOTAL DOMESTIC CREDIT MARKET DEBT OWED BY SECTOR
1981-1986
(In billions of dollars)

	1981	1982	1983	1984	1985	1986
PUBLIC SECTOR	1,456.2	1,704.0	1,992.3	2,293.1	2,726.0	3,171.4
U.S.Government.....	830.1	991.4	1,177.9	1,376.8	1,600.4	1,814.7
State and Local Governments.....	302.1	323.7	357.7	385.1	492.9	550.8
U.S. Government Related Financial Sectors	324.0	388.9	456.7	531.2	632.7	805.9
PRIVATE SECTOR.....	3,509.9	3,733.0	4,090.3	4,683.1	5,304.2	5,949.7
Business.....	1,932.2	2,073.2	2,242.8	2,601.1	2,934.5	3,314.1
Financial Business	340.9	368.9	395.3	459.5	546.5	636.3
Nonfinancial Business	1,591.3	1,704.3	1,847.5	2,141.6	2,388.0	2,677.8
Households (Consumer Sector)*..	1,577.7	1,659.8	1,847.5	2,082.0	2,369.7	2,635.6
TOTAL DOMESTIC CREDIT MARKET DEBT.....	4,966.1	5,436.9	6,082.6	6,976.2	8,030.2	9,121.1
Households' Portion of Total Domestic Credit Market Debt	31.8%	30.5%	30.4%	29.8%	29.5%	29.2%

Source: Federal Reserve Board

* Includes Personal Trusts and Nonprofit Organizations.

TABLE 18

BALANCE SHEET OF THE HOUSEHOLD SECTOR 1982-1986
(End of period in billions of dollars)

	1982	1983	1984	1985	1986
1. Financial Assets (Subtotal)....	7,746.3	8,527.1	9,117.3	10,234.6	11,205.3
a. Demand Deposits and Currency	322.6	362.1	380.9	425.9	529.0
b. Time and Savings Accounts...	1,461.0	1,659.6	1,884.3	2,024.2	2,131.5
c. Money Market Fund Shares....	206.6	162.5	209.7	207.5	228.4
d. Life Insurance and Pension Fund Reserves.....	1,385.2	1,599.1	1,723.2	1,995.0	2,237.2
e. Government Securities (State and Federal).....	484.3	582.7	722.0	839.5	840.8
f. Corporate and Foreign Bonds.	54.8	41.9	38.5	52.4	63.9
g. Corporate Stock at Market Value.....	1,265.7	1,454.2	1,490.7	1,948.0	2,351.5
h. Equity in Noncorporate Business.....	2,291.8	2,365.4	2,356.5	2,356.1	2,609.9
i. Other Financial Assets (net)	274.3	299.8	311.5	386.0	413.1
2. Tangible Assets 1/(Subtotal)...	4,165.3	4,614.5	4,889.4	5,101.7	5,601.1
a. Owner-occupied housing.....	2,017.5	2,187.5	2,307.5	2,380.5	2,589.6
b. Owner-occupied Land 2/.....	685.9	875.0	923.0	952.2	1,087.6
c. Consumer Durable Goods.....	1,141.7	1,206.9	1,292.4	1,393.3	1,527.3
d. Other Tangible Assets 3/....	320.2	345.1	366.5	376.3	396.6
3. TOTAL ASSETS.....	11,911.6	13,141.6	14,006.7	15,336.3	16,806.5
4. TOTAL LIABILITIES.....	1,726.8	1,925.3	2,157.5	2,462.9	2,757.2
a. Home Mortgages.....	1,064.6	1,174.7	1,303.4	1,450.0	1,646.8
b. Consumer Credit.....	418.1	474.8	569.9	666.5	734.4
c. Bank Loans, Insurance Loans, etc.....	244.1	275.8	284.2	346.4	376.0
5. NET WORTH (Line 3 minus Line 4).	10,184.9	11,216.4	11,849.2	12,873.4	14,049.3

Source: Federal Reserve Board.

Note: Parts may not add to totals due to rounding.

*Includes households, personal trusts and non-profit organizations.

1/ Tangible Assets at current cost.
2/ The estimated value of land of the "owner-occupied housing."
3/ Primarily of non-profit organizations.

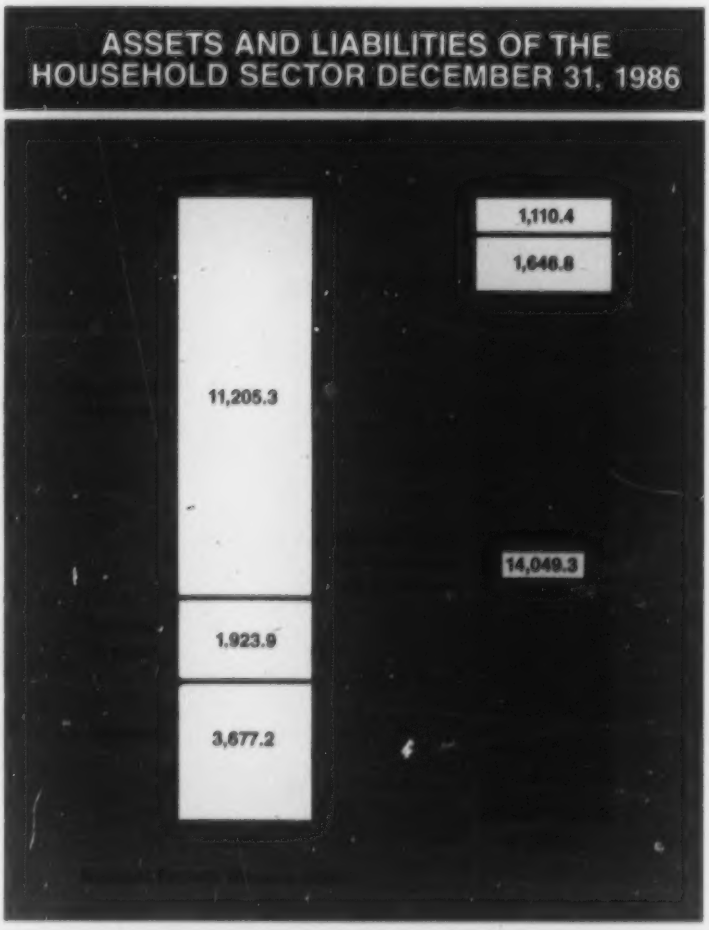
TABLE 19

CONSUMERS' ASSET TO DEBT RATIOS
END OF PERIOD, 1981-1986

Ratio of:	1981	1982	1983	1984	1985	1986
Assets to debts excluding home ownership.....	14.0	13.9	13.4	12.6	11.9	11.8
Home ownership to mortgage debt.....	2.8	2.5	2.6	2.5	2.3	2.2
All assets to all debts.....	7.0	6.9	6.8	6.5	6.2	6.1
Percent of owners' equity in all assets.....	85.7%	85.5%	85.4%	84.6%	83.9%	83.6%

Source: Table 18

CHART 18



6

CONSUMERS' BORROWING AND USE OF FINANCIAL SERVICES

It is a rare coincidence that the purchase of expensive items, especially capital goods, can be financed using the accumulated savings of the purchaser, whether the purchaser be a government, a business or a household. Just as businesses use commercial credit or issue bonds to finance the purchase of capital goods, so do consumer's finance the purchase of tangible assets, homes and consumer durable goods through home mortgages and various other forms of credit. These consumer liabilities will be examined in this chapter.

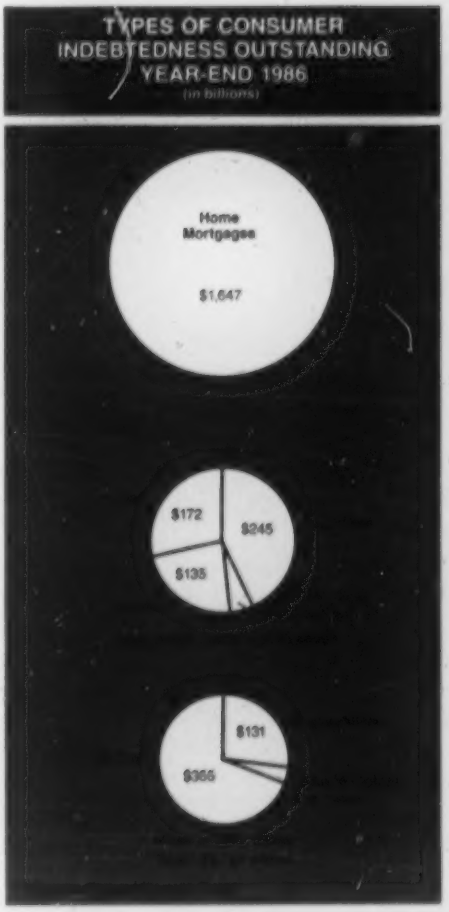
Consumer Credit

As shown in Chart 19, consumers' direct borrowings outstanding amounted to almost $2.76 trillion at the end of 1986. Approximately 60% of households' indebtedness was in the form of home mortgages. About 21% was in the form of installment consumer credit, defined by the Federal Reserve as "most short-end intermediate-term credit extended to individuals through regular business channels, usually to finance the purchase of consumer goods and services or to refinance debts incurred for such purposes, and scheduled to be repaid (or with the option of repaying) in two or more installments." About 5% of consumer debt was noninstallment consumer credit.

Noninstallment Credit

The major categories of noninstallment consumer credit, which is generally of a convenience nature, are single payment

CHART 19



loans from commercial banks, and service credit which represents debts payable to hospitals, physicians, dentists, etc. At the end of 1986 outstanding noninstallment credit was estimated to be about $131 billion.

Consumer Installment Credit

At year-end 1986, consumer installment credit outstanding totaled $586 billion, according to the Federal Reserve Board's Mortgage and Consumer Finance section (Table 20). During the 1970's, increases varied between $2.8 billion in 1970 and $41 billion in 1978. The 1986 increase, was $56.2 and the corresponding rate of increase was 10.4% (Table 21), markedly lower than in the year before (17%).

Due to changes in the data series made available by the Federal Reserve Board, the

TABLE 20

CONSUMER INSTALLMENT CREDIT OUTSTANDING AND NET CHANGE BY TYPE 1981-1986
(In Billions of Dollars, Not Seasonally Adjusted)

	1981	1982	1983	1984	1985	1986
OUTSTANDING AT YEAR END - TOTAL	316.0	332.1	379.7	453.2	530.1	586.3
Automobile						
Commercial Banks	58.1	59.6	67.6	83.9	93.0	100.7
Finance Companies	39.3	44.1	49.8	51.9	69.5	92.4
Revolving						
Commercial Banks	32.9	36.7	44.2	60.5	78.8	89.0
Retailers	27.2	28.9	33.9	36.8	38.5	40.2
Gasoline Companies	4.4	4.1	4.1	4.3	4.3	3.3
Mobile Home						
Commercial Banks	10.2	9.6	9.8	9.6	9.6	8.9
Finance Companies	6.4	9.1	9.4	9.9	9.5	9.1
Other						
Commercial Banks	46.5	46.7	50.4	57.5	63.6	66.3
Finance Companies	24.4	22.1	24.1	28.1	34.4	35.0
Retailers	4.1	3.5	3.7	4.1	4.3	4.5
NET CHANGE DURING YEAR - TOTAL	15.6	16.1	47.6	73.5	76.9	56.2
Automobile						
Commercial Banks	-3.5	1.5	8.0	16.3	9.1	7.7
Finance Companies	9.9	4.4	5.7	2.1	17.6	22.9
Revolving						
Commercial Banks	3.1	3.8	7.5	16.4	18.3	10.2
Retailers	2.9	1.7	5.0	2.9	1.7	1.7
Gasoline Companies	-0 1	-0.3	0.1	0.2	0.0	-1.0
Mobile Home						
Commercial Banks	-0.2	-0.6	0.2	-0.2	0.0	-0.7
Finance Companies	1.2	2.7	0.4	0.5	-0.4	-0.4
Other						
Commercial Banks	1.1	0.2	3.7	7.1	.6.1	2.7
Finance Companies	-3.3	-2.3	2.0	4.0	6.3	0.6
Retailers	-0.3	-0.6	0.2	0.4	0.2	0.2

Source: Federal Reserve Board.
Note: Parts may not add to totals due to rounding.

credit types and lender categories discussed here have been changed slightly. Lenders in the two classes previously described as "Savings and Loan Associations" and "Mutual Savings Banks" have now been combined as "Savings Institutions". Additionally, not all series for types of credit are available. The tables in this chapter and the next reflect these changes.

Of the consumer installment credit outstanding at the end of 1986, 45% was held by commercial banks, 23% by finance companies, 13% by credit unions, 8% by retailers, 10% by savings institutions and less than 1% by gasoline companies.

Rates of Charge

Annual interest rates charged by finance companies on purchased retail automobile paper in December 1986 averaged 11.71% for new cars (down from 12.52% in December 1985) and 15.12% for used cars, also down slightly. The average rate on new car contracts for the year, however, was even lower (9.4%), due to the incentive programs offered by the auto finance companies periodically throughout the year. The most frequent rate charged on direct loans by banks to consumers to finance new automobiles over a 48 month period in the

TABLE 21

CONSUMER INSTALLMENT CREDIT, BY TYPE AND HOLDER, 1986
(In Millions of Dollars, Not Seasonally Adjusted)

	Outstanding Year-end 1985	Net Change 1986	Outstanding Year-End 1986	Percent Increase during 1986
Total Installment Credit.....	530,968	55,291	586,259	10.4%
Commercial Banks.....	245,055	19,774	264,829	8.0%
Finance Companies.....	113,398	23,183	136,581	20.4%
Credit Unions.....	72,715	5,793	78,508	8.0%
Retailers.....	42,776	1,903	44,679	4.5%
Savings Institutions.....	52,720	5,671	58,391	10.8%
Gasoline Companies.....	4,304	-1,033	3,271	-24.0%
Automobile				
Commercial Banks.....	93,012	7,659	100,671	8.2%
Finance Companies.....	69,532	22,916	92,448	33.0%
Revolving				
Commercial Banks.....	78,850	10,102	88,952	12.8%
Retailers.....	38,473	1,720	40,193	4.5%
Gasoline Companies.....	4,304	-1,033	3,271	-24.0%
Mobile Homes				
Commercial Banks.....	9,587	-728	8,859	-7.6%
Finance Companies.....	9,469	-384	9,105	-3.8%
Other				
Commercial Banks.....	63,606	2,741	66,347	4.3%
Finance Companies.....	34,397	631	35,028	1.8%
Retailers.....	4,303	183	4,486	4.2%

Source: Federal Reserve Board.
Note: Parts may not add to totals due to rounding.

first week of November 1986 was 10.58%. Most of the financing by retailers is in the form of revolving credit at rates probably approximating the rate on bank credit cards which averaged 18.09% in November 1986. The rate for November 1985 had averaged 18.57%.

Surveys of Consumer Finances

During this century, consumers have been surveyed frequently, if irregularly, by various parties interested in collecting information on their "consumption" of financial services. Such information has been of interest to many groups, among them government bodies seeking to create legislation and regulation for the consumer financial services industry; the industry itself, seeking to market its services to individuals; economists; and others.

The Federal Reserve first sponsored a survey of consumer finances just after World War II. Surveys were conducted by the Survey Research Center of the University of Michigan annually from 1947 through 1970, but then were discontinued. In 1977, balance-sheet data were collected as part of a survey of consumer credit sponsored by various federal banking agencies.

The interview questionnaire for this survey probed two significant aspects of consumer credit. First, it explored use by consumers of different types of credit, updating the *Surveys of Consumer Finances* undertaken by the Survey Research Center until 1971. Second, it measured consumers' awareness, understanding, attitudes and behavior regarding credit and its regulation, a largely unresearched area previously. Authored by Thomas A. Durkin and Gregory E. Elliehausen and published by the Federal Reserve Board as the *1977 Consumer Credit Survey*, the report examines lines of direct and indirect questioning used to gather information about the variables, as well as the responses obtained. Chapters 2 and 10 examine the responses to questions on consumer credit protection legislation. Chapters 11 to 21 review consumers' income, assets, debts, and housing; they also update many of the tables from the earlier *Surveys of Consumer Finances*.

In 1983, the Board of Governors of the Federal Reserve System, the United States Department of Health and Human Services, and five other federal agencies joined together to sponsor the 1983 Survey of Consumer Finances. The earliest results of this project became available to the public in late 1984. To date, two articles summarizing certain findings of the survey have appeared in the September and December, 1984 issues of the *Federal Reserve Bulletin*. In the first of these two articles, the authors note that, "(T)he recent survey provides a unique opportunity to link data on consumer assets and liabilities, income, and financial behavior."

The 1983 survey examined the collective "financial position" of American consumers by estimating the debt obligations and asset holdings of a nationally representative sample of American families. By collecting further details on these obligations and holdings, more specific information on consumers' use of financial institutions and products was obtained.

Between February and July of 1983, 3,824 families (defined as "include(ing) all persons residing together in the same dwelling who are related by blood, marriage, or adoption" . . . and . . . "include(ing) one-person units as well as units of two or more persons") agreed to grant personal interviews. The interviews included questions covering balance sheet items as of the interview date, and income from the previous year (1982). Respondents were "encouraged to consult other family members and financial records in an effort to obtain complete and accurate responses."

Home equity was found to be the largest asset of many homeowners, who comprised 64% of all families surveyed. Overall mean net equity in nonfarm homes was $56,133, although it varied considerably with household characteristics such as income, age, race, and life cycle stage.

Checking accounts were the most common financial asset, owned by 79% of families. The median checking account balance was $500. Savings accounts were the next most common financial asset, being maintained by 65% of families. Liquid assets other than checking and savings accounts were more

popular than they had been in earlier years, presumably due to regulatory changes since the previous consumer surveys making available new deposit instruments and an associated increased willingness among savers to diversify. Certificates of deposit and savings bonds were held by more than one fifth of the surveyed families. Money market accounts and the less liquid retirement accounts were held by 14% and 17% respectively.

Nondeposit financial assets (stocks and bonds) were not as widely held, although 19% of the sample group owned stocks in amounts averaging just over $4,000. Furthermore, it was discovered through questions regarding the content of stock portfolios and the frequency of transactions that most of these stockholders were neither diversified in their holdings nor were they active traders. For owners of all non-liquid financial assets, and especially those with bonds and non-taxable holdings such as municipal issues, the median amount of total financial assets was well above the median for all families, which was $2,300. These and other survey results indicate that ownership of financial assets is highly concentrated among a small group of families.

The survey data provide detailed information on some financial characteristics of families with certain types of liabilities (Table 22). Looking first at the frequency of various liabilities, only 37% of families had mortgage debt outstanding (although 64% of families were homeowners). A larger portion of families, 62%, had some type of consumer credit outstanding, including credit from finance companies, retail stores, banks, savings & loans, credit unions, and other sources. 42% of families had bank credit cards, while 10% had travel and entertainment (T&E) cards.

The mean amount of consumer credit outstanding among all families was $5,400, but the median amount was only $2,382, indicating a high occurrence of small amounts outstanding. This conclusion is borne out in the distributions shown in Table 23.

Consumers whose main checking account was at a commercial bank tended to have slightly larger amounts of consumer installment credit outstanding than those with checking accounts elsewhere (not shown in table). Those with main checking accounts at credit unions were the most likely to have consumer debt outstanding, regardless of amount. This situation presumably arises primarily because of the nature and purpose of the credit union as a financial institution.

Families with checking account balances below $2,500 were much more likely to owe both mortgage debt and non-mortgage consumer debt than were families with larger checking account balances. However, families maintaining small account balances averaged only $5,466 in consumer debt outstanding, compared with $14,305 for those with larger checking account balances.

Owners of money market deposit accounts, money market mutual fund shares, and brokerage accounts all had higher average consumer credit balances outstanding than the mean consumer debt among all families. Among these 3 groups, however, money market deposit holders had much smaller consumer credit balances outstanding (averaging $7,266) than did money market mutual fund and brokerage account owners, whose consumer credit balances averaged $12,370 and $10,635 respectively.

Among credit card users, holders of cards other than bank cards (i.e., gasoline, T&E, proprietary retail, and other credit cards) were likely also to hold bank cards. Among each of the groups of cardholders, between 65% and 80% also held bank cards. Such was not the case for T&E cards, which were held by between only 14% and 40% of families having other credit cards.

By types of lending institutions, average amounts of credit reported owed by consumers appear quite homogeneous, not only as measured by mean but also by median amounts (the latter with the exception of consumer debt at retail establishments). It should also be noted that the disparity between the mean and median amounts of consumer debt reported by interviewees for all families is largely due to the even larger disparity between mean and median amounts at "stores," which includes dealers. For financial institutions alone, the mean and median are actually quite close.

TABLE 22

SELECTED CHARACTERISTICS OF FAMILIES USING FINANCIAL SERVICES, 1983

	Percent of all families	Credit Card Holders		Have mortgage debt	Have consumer debt*	Amount of Consumer Debt**	
		Bank	T & E			Mean	Median
						(dollars)	
Average balance in main checking account:							
Less than $2,500....	71	50	11	44	69	5,466	2,751
$2,500 or more.....	8	56	21	29	39	14,305	4,011
Other financial services used and financial characteristics:							
Money market deposit account...	8	65	17	41	48	7,266	3,175
Money market mutual fund account	6	80	30	49	70	12,370	4,000
Brokerage account...	7	82	30	54	64	10,635	4,000
Nonliquid financial assets.	23	68	20	49	64	8,047	3,648
Saving and investment advice	26	52	15	40	62	7,525	2,614
Type of credit card held:							
Gasoline.....	28	77	22	51	74	7,667	4,002
Bank.....	42	100	18	53	77	6,873	3,321
T & E.....	10	80	100	62	80	11,147	5,345
National retailer...	48	65	14	52	76	5,778	3,100
Other retailer.....	37	69	18	50	75	6,164	3,000
Other.....	5	80	40	54	81	9,436	3,391
Source of outstanding credit:							
Commercial Bank.....	19	54	14	51	100	7,869	4,430
S&L or Savings Bank.	3	56	16	60	100	6,409	4,365
Credit Union.....	7	60	13	63	100	6,274	4,705
Finance Company.....	12	44	9	46	100	6,927	4,183
Store.....	7	37	9	40	100	5,533	1,940
All Families.....	100	42	10	37	62	5,400	2,382

* Includes credit card, other installment, and non-installment credit.
** Covers only families that have such debt.

Source: Board of Governors of the Federal Reserve System.

TABLE 23

DISTRIBUTION OF CONSUMER DEBT OUTSTANDING, SELECTED YEARS
(Percent of families with such debt)

	Current dollars			Constant dollars		
	1970	1977	1983	1970	1977	1983
Amount of consumer credit outstanding (dollars)						
None	46	37	18	46	37	38
1-499	20	15	13	11	12	13
500-999	9	10	6	5	6	6
1,000-1,999	12	11	9	9	10	9
2,000-2,999	6	8	6	5	6	6
3,000-4,999	5	11	9	9	10	9
5,000-7,400	2	5	7	6	9	7
7,500 and more	1	4	12	8	11	12
Total	100	100	100	100	100	100
Mean (dollars) *	1,438	2,713	5,400	3,686	4,450	5,400
Median (dollars) *	858	1,599	2,382	2,199	2,622	2,382

* Averages only among families that have such debt.

Source: Federal Reserve Board

Incidence of Consumer Credit Usage

The 1983 survey found that 62% of all families owed no consumer installment debt. Exactly one-quarter of all families had installment debt payments (excluding home mortgages) of less than 10% of family income; 11% had payments of 10-19%; and 5% had payments of 20% or more (Table 24).

The study also shows the level of commitment for installment debt repayment by age of the family head. 25% of the families in which the family head was under 25 had 10% or more of their disposable income committed to repayment of installment credit. This percentage dropped to 22% for the 25 to 34 year age group, 20% for the 35 to 44, 17% for the 45 to 54 year, and 13% for the 55 to 64 year age groups. Only 7% of those in the 65 to 74 year age group, and 4% of those 75 years of age and over had 10% or more of their previous years' disposable income committed to repayment of installment credit in 1983.

Repayments as a percent of disposable income vary also by income level of spending unit. For the low income levels (under $5,000 per year), 84% of households had no installment payments in mid-1983 and another 3% had payments of under 10% of disposable income. Of these lower income families, most who did owe installment debt did so at levels greater than 20% of income. Among families with income of $50,000 and over, 53% had no installment payments and 39% had payments of less than 10% of disposable income. Families with incomes between $40,000 and $50,000 were the most likely to be credit users, over 58% of these families owing some installment credit in 1983. In contrast to the relatively high levels of debt burden among low-income installment borrowers, the majority of high-income borrowers made payments of less than 10% of income.

TABLE 24

RATIO OF MONTHLY INSTALLMENT DEBT* PAYMENTS IN 1983 TO FAMILY INCOME IN 1982, BY SELECTED FAMILY CHARACTERISTICS

(Percent of family income)

	No Debt	Less than 10%	10% to 19%	20% or more	Total
All Families.....	59	25	11	5	100
Age of Family Head (years)					
Under 25.....	55	21	16	9	100
25-34.....	45	34	15	7	100
34-44.....	45	36	14	6	100
45-54.....	51	31	12	5	100
55-64.....	68	18	9	4	100
65-74.....	86	7	4	3	100
75 and over.....	94	2	2	2	100
Family Income (dollars)					
Less than 5,000.....	84	3	3	10	100
5,000-7,499.....	79	7	4	10	100
7,500-9,999.....	65	14	12	9	100
10,000-14,999.....	66	14	13	7	100
15,000-19,999.....	56	21	17	6	100
20,000-24,999.....	51	27	18	5	100
25,000-29,999.....	50	31	16	3	100
30,000-39,999.....	44	45	10	1	100
40,000-49,999.....	42	47	9	2	100
50,000 and more.....	53	39	8	1	100

Source: Federal Reserve 1983 Survey of Consumer Finances.
Note: Parts may not add to totals due to rounding.
* Does not include noninstallment credit.

7

THE CONSUMER FINANCE INDUSTRY

The consumer finance industry is here defined as including those corporations, partnerships or proprietorships whose primary purpose is to provide credit to consumers. Both direct and indirect financing means are included.

Institutions specializing in this business are generally known as consumer finance companies, sales finance companies, industrial banks and industrial loan companies. At the end of 1986, such companies held $137 billion in installment credit outstanding, approximately $92 billion in automobile credit, $9 billion in mobile home credit, and $35 billion in personal loans and credit to finance the purchase of other consumer goods and home improvements.

Many institutions are involved in financing consumers' purchases of goods and services. Commercial banks offer various types of consumer credit, including auto and personal installment loans as well as bank card accounts. Most savings institutions also offer some form of personal loan as an adjunct to their major role of financing homes, and credit unions have as one of their major functions the granting of loans to members. Each of these institutions, however, also has a collateral role—that of accepting time and/or savings deposits as a major method of obtaining the funds to be loaned out. Retail outlets also make credit available to their customers as a convenience but they exist primarily to sell merchandise and do not take in deposits to fund this activity directly. Consumer finance companies therefore are the only institutions whose primary role is to make installment credit available to consumers. Accordingly, retailers as a group, and most depository financial intermediaries (including commercial banks, savings and loan associations, and credit unions), which have the dual functions of receiving funds from savers and lending to borrowers, are not included in the following discussion of the consumer finance industry. Finance company subsidiaries of bank, insurance, and other holding companies are included.

Industrial banking companies or Morris Plan companies (known variously as thrifts, industrial loan companies and other titles) which operate in 20 states are permitted to, and some do, accept consumers' savings deposits in various forms (thrift certificates and investment certificates are two examples). Those industrials which accept deposits or deposit-like instruments are, in a real sense, depository financial institutions although they are usually grouped with finance companies because their charters are most frequently held by subsidiaries of finance companies and they are in many cases regulated by a state consumer credit administrator.

Size and Ownership

Finance companies vary in size and ownership from single office independently owned and operated companies to large chain companies with hundreds of offices across the country. Some medium-size and

TABLE 25

RECEIVABLES OUTSTANDING AT FINANCE COMPANIES BY TYPE, 1981-1986
(In Billions of Dollars, Not Seasonally Adjusted)

	1981	1982	1983	1984	1985	1986
Total	186.3	194.3	217.3	251.5	300.6	344.4
Consumer Credit - Total	70.0	75.2	83.3	89.9	113.4	136.6
Automobile	39.3	44.1	49.8	51.9	69.5	92.5
Mobile Home	6.4	9.1	9.4	9.9	9.5	9.1
Other	24.4	22.1	24.1	28.1	34.4	35.0
Business Credit - Total	99.4	100.3	113.4	137.8	158.3	174.2
Automobile	28.1	27.3	34.7	47.1	61.3	69.2
Other than Automobile	71.3	73.0	78.7	90.7	97.0	105.0
Loans Secured by Real Estate	16.8	18.7	20.5	23.8	28.9	33.6

Source: Federal Reserve Board
Note: Parts may not add to totals due to rounding.

large companies are independently owned, others are subsidiaries of manufacturers, bank holding companies, insurance companies, or conglomerate firms. Alternatively, some companies themselves have insurance and retail subsidiaries, some offer commercial financing in addition to consumer financing, some have manufacturing subsidiaries and some have subsidiaries which operate in Canada and overseas.

Market Size and Growth

Until well into the 1960's, finance companies were generally highly specialized and could be distinguished as consumer finance companies, sales finance companies or commercial finance companies. However, by the late 1970's, most large and medium-size, and many small finance companies had become more diversified, both as to lending (assets) and as to sources of funds (liabilities). During the 1970's, diversified giants from outside the industry recognized finance companies as well-managed profit centers and many finance companies were acquired by such conglomerates. Also, the passage of the Bank Holding Company Act amendments of 1970 provided the legal basis for bank holding companies to increase their acquisitions of finance companies.

Table 25 shows consumer and business financing by finance companies since 1981. At the end of 1986, consumer receivables constituted 40% of the $344 billion in receivables, while business credit in the amount of $174 billion constituted 50%. This distribution is quite different from the 52% and 48% reported in 1983 and earlier years, in large part because of a statistical redefinition by the Federal Reserve Board which now excludes real estate-secured personal loans (generally second mortgages) from consumer credit. When the estimated amount of second mortgage personal loans outstanding at finance companies at the end of 1986 ($34 billion) is included as consumer credit, the distribution between consumer and commercial credit outstanding becomes almost an even 50-50 for 1986.

During the first half of the 1970's, the percentage of total consumer installment credit held by finance companies declined from 26.1% at the end of 1970 to less than 20% in the late 1970's. The market share of finance companies in consumer credit has been affected quite a bit by the above-

TABLE 26

CONSUMER INSTALLMENT CREDIT AT FINANCE COMPANIES, 1981-1986
(Not Seasonally Adjusted in Millions of Dollars)

	Total	Automobile	Mobile Home	All Other*
Outstanding (end of period)				
1981	70,070	39,320	6,398	24,352*
1982	75,271	44,121	9,070	22,080
1983	83,310	49,810	9,420	24,080
1984	89,884	51,915	9,877	28,092
1985	113,398	69,532	9,469	34,397
1986	136,581	92,448	9,105	35,028
Net Change				
1982	5,201	4,801	2,672	-2,272
1983	8,039	5,689	350	2,000
1984	6,574	2,105	457	4,012
1985	23,514	17,617	-408	6,305
1986	23,183	22,916	-364	631

Source: Federal Reserve Board
Note: Parts may not add to totals due to rounding.

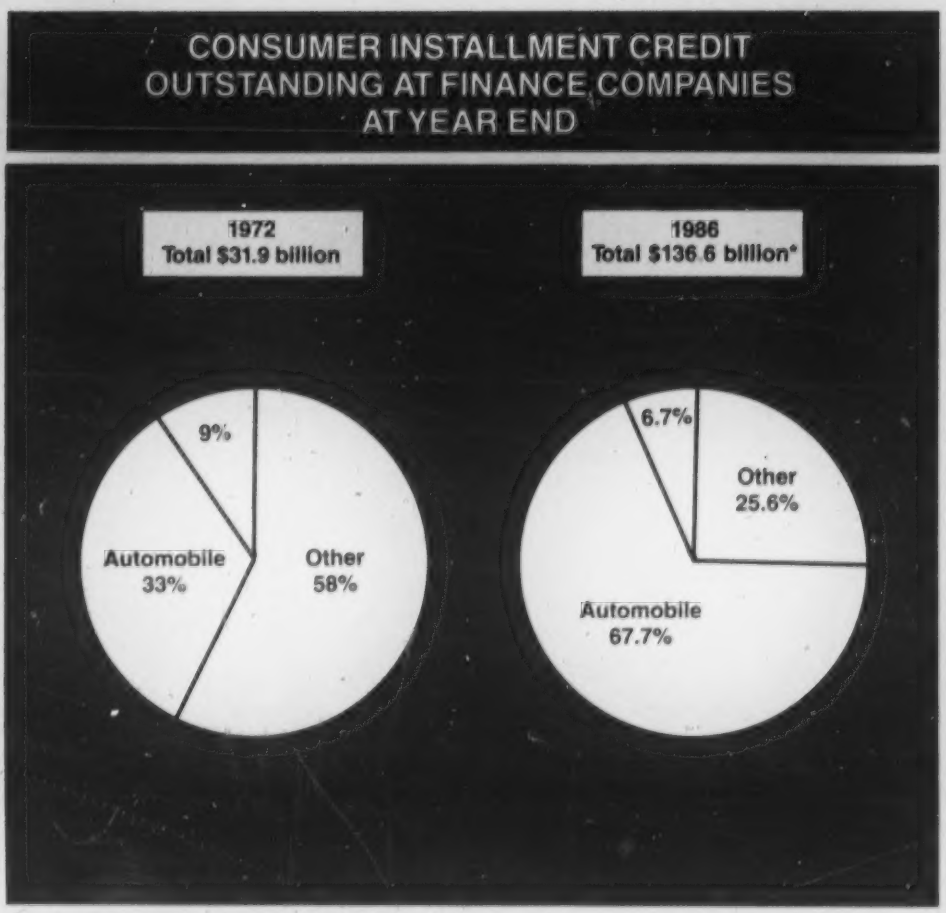
* Includes personal loans (further breakdown is not available).

mentioned revision (regarding second mortgages). According to the new data, in 1980 it stood at 21%, rose until 1982 to 23.3% and has fallen in both 1983 and 1984, when it was again an even 21%. The reversal from the late 1970's reflected the entry of finance companies into new markets (especially large loans secured by real property and, to a lesser extent, open-end credit) and greatly increased penetration in automobile credit during the difficult economic period of 1980-82 that led to bank and credit union retreats from the market. The 1983 and 1984 declines in the consumer market share of finance companies is at least partly explained by renewed interest on the part of these other institutions in auto credit markets during periods of economic expansion. Once again in 1985 it was in auto credit that much of the change took place. Finance companies' market share increased to 22%, largely due to a 34% increase over the year in the amount of finance company auto credit outstanding. The auto finance companies spent much of the year offering "incentive programs," or extremely low interest rates, on loan contracts for the purchase of certain new car models. Clearly, the effect was to increase both auto sales and associated credit extensions. In 1986, the same scenario repeated itself with total installment credit at finance companies increasing by 20.4%, carried by a 33% increase in outstanding automobile credit. Finance companies' share of total consumer credit rose to 23.5% by the end of 1986. The new tax law added some momentum by elimating deductions for consumer interest payments, thus giving more incentive for prospective car buyers to purchase new cars before December 31, 1986.

Lines of Consumer Business

At the end of 1986, the $136.6 billion in consumer installment credit held by finance companies consisted of approximately

CHART 20



$92.5 billion in retail automobile paper (68%), $9.1 billion in mobile home credit (7%) and $35 billion in other forms of consumer installment credit (25%) (Table 26). Although the previously available series for the amount of personal loans outstanding at finance companies has been discontinued, AFSA estimated that of the $113.4 billion in 1985 in consumer credit, around one sixth, or 15%, represents direct loans to individuals. Such a distribution would leave a residual of almost 17% as "other" credit, including appliance paper, home improvement loans, etc. Many finance companies now offer a combination of these consumer credit products as opposed to some years ago when many were highly specialized and offered few types of loan products. The distribution of "other" consumer credit in 1986 is likely to be close to that of 1985.

Although most finance companies and industrial banking companies now in operation had their early beginnings in the direct cash loan field, many others started in the retail sales financing business. Most have subsequently added the other services as a means of providing more complete service for existing customers or as a means of attracting new customers. Financing of automobiles and other consumer durable goods, the specialty of the sales finance company, is frequently a marginal profit activity, nearly always requiring a large volume for success. Particularly in the financing of relatively small purchases,

the total income from finance charges barely covers the cost of putting an account on the books, and is often inadequate to cover the cost of servicing over a period of months or years.

Revolving or open-end consumer credit business has been growing but is still not a major line of business for most finance companies, partially because of restrictive legislation. However, with the increasing use of electronic fund transfers, many companies are showing an interest in expanding this type of service. AFSA data show that revolving consumer credit has comprised about 3½% of the consumer receivables of a sample of finance companies in 1984 and 1985, up from 1½% or less in earlier years.

Automobile Financing

As automobile and other manufacturers expanded the operations of their finance company subsidiaries, and as retail chains established their own finance subsidiaries, the market for independent sales finance companies decreased. In addition, during the early 1970's, commercial banks and credit unions became increasingly aggressive in auto financing. After 1979, however, other higher earning markets for commercial bank lending beckoned, and credit unions faced shortages of funds. These institutions' participation in auto financing then lessened. A resulting shift back to finance companies was evident in Federal Reserve statistics, which showed that finance companies' share of total automobile credit outstanding rose from 26% in 1980 to 33% and 35% in 1981 and 1982 respectively. With continued economic recovery, however, commercial banks had again become more prominent as holders of auto credit (as much a result of improved auto sales as of an effort to increase such lending). And, as banks' share of outstanding auto credit increased from 47% in 1982 and 1983 to 49.5% in 1984, finance companies' share slipped, from 35% to 30%.

Since then, however, finance companies have reclaimed some of the business that had been eroded by other lenders. Low rate financing programs were offered periodically, usually for a limited time and often only on certain models of cars. Annual percentage rates as low as 2.9% were offered by some companies. The average of rates offered by the 3 major auto finance companies for new car loans during some months of 1986 came down to 5.4% and 6.12% (in September and October, the busiest months). Consumers were urged to purchase a new car before the 1986 tax law eliminated deductions on consumer interest payments. Sales (and therefore credit extensions) soared during the incentive programs, so much so that the auto makers have found sales lax during the periods in which no programs were offered. Nevertheless, at the end of 1986, finance companies' share of auto credit had reached 38%.

Mobile Home Financing

Financing the purchase of mobile homes is a rather volatile portion of finance companies' business. In the mid-1970's, for example, around as much as 11% of finance company outstandings were mobile home loans. This proportion fell below 8% in the late 1970's, rose to almost 12% in 1982 and in 1986 was down to 6.7%. At the end of 1986 there were $9.1 billion in this type of receivable outstanding, about the same amount as in 1984 and 1985.

Sales Financing

The medium of a retail sales financing service has in the past provided the consumer finance company with an opportunity to attract new direct loan customers. Traditionally the customer (buyer) entered into a contract with a dealer (seller) to buy a refrigerator, for example. The dealer, in turn, would resell the contract to, or "discount" the "paper" with a finance company by assigning it (endorsing the contract) to the finance company. The buyer would make monthly payments directly to the finance company under the same terms and conditions as those of the contract with the seller. In such a transaction, as the customer proved his or her credit-worthiness by the manner in which payments on the refrigerator were made, the finance company

TABLE 27

GROWTH IN SECOND MORTGAGE AND OTHER PERSONAL LOANS AT A SAMPLE GROUP OF FINANCE COMPANIES, 1977-1985

(In millions of dollars)

	Personal Loans			Total Consumer Receivables
	Total	Second Mortgage	Other	
1977	14,529	2,471	12,058	37,679
1978	17,070	3,783	13,287	45,539
1979	21,501	6,976	14,526	57,927
1980	22,939	10,323	12,615	63,729
1981	24,165	13,148	11,016	74,810
1982	23,817	14,019	9,798	77,903
1983	24,301	13,846	10,455	85,584
1984	26,521	14,621	11,900	94,743
1985	29,333	15,604	13,729	120,968

Source: American Financial Services Association Surveys

gained a customer to whom it could then also offer its direct loan services. The customer established a credit relationship with the finance company which could be drawn on at a time when he or she might need credit. With the expanded use of revolving credit in the 1970's, finance companies began to offer such sales finance service through the use of credit cards or private label financing. Although there is no available measure of the amount of such revolving credit outstanding, it is included in the "other" consumer credit outstanding at finance companies at the end of 1986.

Personal Cash Loans

Another major finance company product is the personal loan, which is nothing more than a loan, the proceeds of which are paid directly to the borrower. Personal loans are made or taken out for a variety of purposes and have a variety of characteristics. Some are short-term and unsecured; some are "secured" by the presence of a cosigner. Personal loans are increasingly frequently made in relatively large amounts and for extended terms when they are secured by real property. There is also an increasing amount of money advanced as open-end loans secured by real estate, and even some with adjustable interest rates. Most real estate-secured loans take the form of a junior mortgage, any existing mortgage(s) being senior. Of course, there are some cases in which a loan is classified as a "personal loan" but may actually be used for a purpose which might qualify it as some other kind of loan. For example, the proceeds might be used to purchase a used car, or for tuition expenses. In this discussion, it is the fact of being paid directly to the borrower that distinguishes personal loans.

Finance companies' outstandings of personal loans are no longer estimated by the Federal Reserve Board, and in fact, the real-estate secured loans would not be included in the Fed's definition of consumer installment credit, although they are made directly to individuals, for consumer purposes, and are repaid in installments. Based on our research, AFSA estimates that of the $34 billion of "other" consumer credit at the end of 1985 shown in Table 26, somewhere in the area of 47% is personal loans, exclud-

TABLE 28

AVERAGE LOAN SIZES AT FINANCE COMPANIES, 1981-1985

	Loans Made (excluding unearned charges)	Loans Outstanding (including unearned charges)
Second Mortgage Personal Loans		
1981 (53 companies)	$13,354	$14,675
1982 (62 companies)	$13,464	$16,644
1983 (64 companies)	$14,818	$14,855
1984 (62 companies)	$16,505	$16,227
1985 (72 companies)	$16,577	$16,529
Other Personal loans		
1981 (53 companies)	$1,561	$1,433
1982 (62 companies)	$1,731	$1,901
1983 (64 companies)	$1,924	$1,832
1984 (62 companies)	$1,996	$1,914
1985 (72 companies)	$2,097	$2,090

Source: American Financial Services Association Surveys.

ing those secured by real estate. This distinction cannot be documented in 1986. In addition, the Fed publishes a series showing about $34 billion of real estate secured loans at finance companies in 1986, up from $29 billion in 1985.

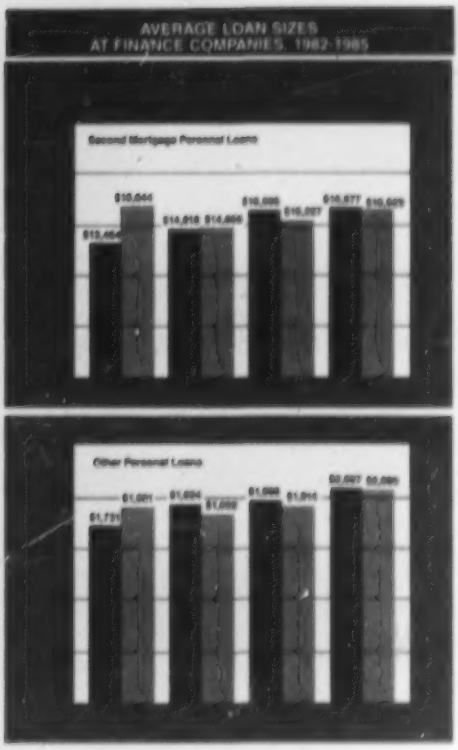
Larger amounts loaned on second mortgages make the fixed transaction costs of making the loans small as a percent of the amount loaned, and the security (in the form of home equity) makes this kind of personal loan an attractive product for consumer finance companies. While detailed and comprehensive data on the second mortgage loan market are not available, it is generally believed that finance companies are the largest holders of such credit.

AFSA's Research Report and Second Mortgage Lending Report Supplement 1977-1985 reveals a pattern of strong growth in seconds at a consistent sample of such companies over the period. There was a small (1.3%) temporary decrease in 1983 (Table 27). The year-to-year increases in second mortgages at this group of finance companies have been as high as 83% (in 1979). After the decline in 1983, which seems to have been an indication of caution after such rapid growth in the previous years, rather than an actual withdrawal from second mortgage lending, second mortgage loans outstanding increased again by 5.6% followed by an increase of 6.7% in 1985. Other personal loans also grew, by 15.4% in 1985. Even so, personal loans continued a several-year decline as a share of consumer and total receivables at finance companies. Some of the decline, however, may be explained by the movement of some personal credit into the "revolving" category.

Loan Sizes

Both legal and economic factors affect the size of loans made by finance companies. In the case of finance companies, unlike many other types of financial institutions, the legal factors are determined at the state level. Finance companies are not federally regulated (except where their status as a bank holding company or the

CHART 21



subsidiary of a bank holding company dictates otherwise), although certain regulations of the Federal government do apply to them. As a result, there is a complicated patchwork of state regulations and regulatory bodies dictating certain aspects of the operations of licensed lenders, finance companies, loan and investment companies, etc. Of course, the statutory limits on finance companies are determined by the states' legislatures. One of these limits is the "loan ceiling" which is a limit on the size of loans made. Maximum loan sizes have been increasing in recent years, although the trend is not universal.

Economic decisions regarding the size of loans made are affected by the relationships between the loan ceilings, maximum authorized rates (as set out by usury laws) and the demand for loans of various sizes.

Finance companies generally try to offer full loan services. That is, they try to serve customers who need both small and large loans. However, the yield on small loans is often considerably below the cost of making the loans, making it economically impossible for any institution to have a very large proportion of loans outstanding in the form of very small loans. Rising consumer prices, however, have reduced the consumer demand for very small loans, alleviating this problem somewhat.

According to AFSA surveys of member finance companies, the average size of second mortgage personal loans made (at 62 responding companies) in 1985 was $16,577 (excluding unearned charges). This compares with an average non-second mortgage personal loan size of $2,097 (Table 28 and Chart 21).

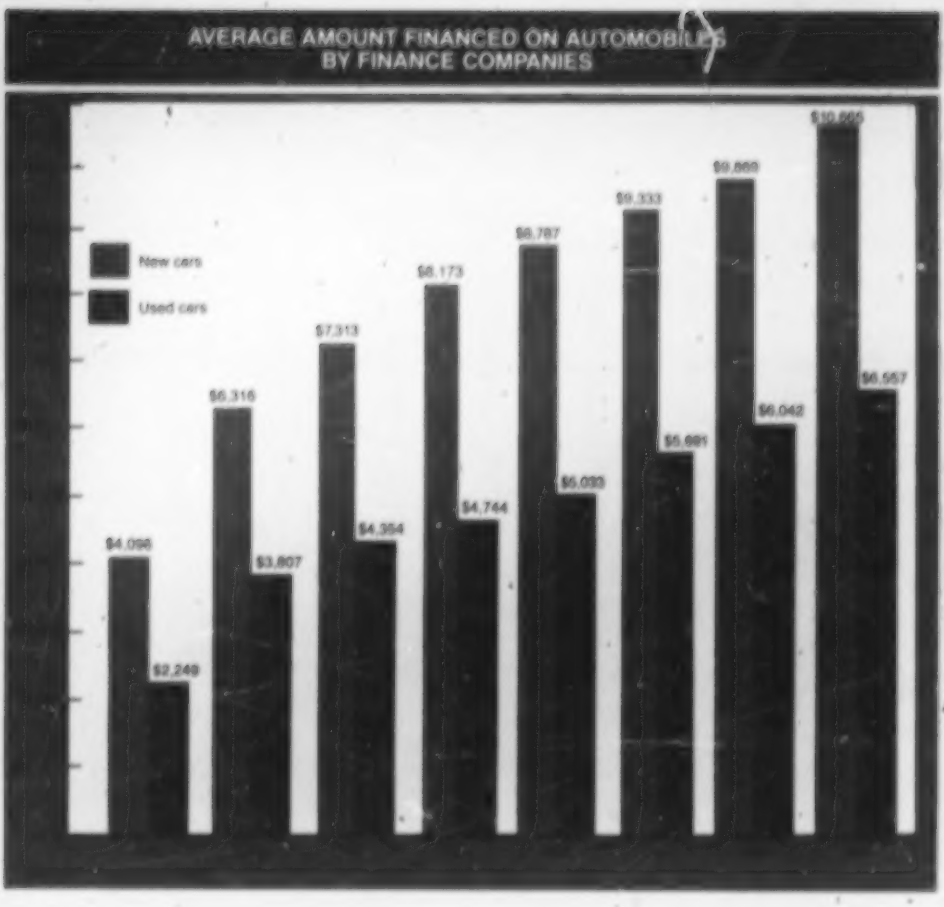
The same companies also provided sufficient detail to show average size second mortgage loans outstanding of $16,529 (including unearned charges) and average size non-seconds outstanding at $2,090.

Automobile contracts are generally much larger than (non-second-mortgage) personal loans. Federal Reserve data reveal that the average amount financed on new automobiles (again excluding precomputed charges) increased from $9,869 in 1985 to $10,665 in 1986 (Chart 22). For used cars, the amount advanced by finance companies increased from $6,042 in 1985 to $6,557 in 1986.

Rates Charged by Finance Companies

Laws governing the maximum rates that consumer installment credit companies may charge are determined by each state and often differ for different types of loans. Unfortunately, very little information is available about rates actually charged by finance companies for specific types of loans, but a few clues are available. (All rates quoted here are annual percentage rates (APR), calculated in the manner prescribed by the Truth in Lending Law). According to the Federal Reserve Board, the annual rate charged by finance companies in 1986 for financing of new autos averaged 9.4% and for used autos 16.3%.

CHART 22



Types of Rate Quotation

Prior to passage of the Truth in Lending Act, various types of rate quotation were permitted (or required) by states. Two specific cases involving small loans provide an example. Both rate systems lumped all finance charges into a single rate, although additional charges were permitted (and regulated) in most states to cover the cost of insurance when the borrower desired such coverage. Both forms of quotation also permitted the borrower to repay a loan without penalty at any time before the contract matured.

The older form of rate quotation was the percent per month of the unpaid balance. Illinois' small loan law, for example, was of this type and permitted charges as follows: 2½% per month on the first $300 outstanding, 2% per month on the amount between $300 and $600 outstanding, and 1½% per month on the amount between $600 and $3,000 outstanding. Applying these rates, a $1,000 loan repaid in 12 equal monthly installments of $95.36 would cost the borrower $144.32 in interest. This amounts to an effective APR of 25.67%, measured according to the Truth-in-Lending method.

TABLE 29

PERCENTAGE DISTRIBUTION OF PERSONAL LOANS MADE AT FINANCE COMPANIES IN 1985, BY PURPOSE

	Percent of Reported Loans Made in 1985	
Second Mortgage Personal Loans	Number	Amount
Purchase or Transfer of Primary Residence	1.7%	1.9%
Other Real Estate Purchase	2.8%	4.4%
Other	95.5%	93.7%
TOTAL	100%	100%
Number of Companies:	11	
Number of Cash Loan Offices:	1,953	
Average Size Loans Made:	$16,269	
Other Personal Loans		
Consolidation of existing bills	17.7%	17.8%
Travel, vacation and education expenses	10.1%	8.9%
Automobile purchase or repair	12.3%	13.0%
Home furnishing and appliances	3.5%	2.9%
Household repairs	5.2%	5.6%
All other purposes	51.2%	51.8%
TOTAL	100%	100%
Number of Companies:	10	
Number of Cash Loan Offices:	4,048	
Average Size Loan Made:	$2,239	

Source: American Financial Services Association Surveys.

Many states also adopted a form of rate quotation for small loans similar to that frequently used by retail stores in pricing consumer installment credit. This form of quotation is referred to as add-on, meaning that a certain number of dollars is added to the amount of the contract to be repaid. Ohio's small loan law is an example of this type, allowing $16 add-on per $100 per year up to $750, $11 per $100 per year on the amount between $750 and $1,500, and $9 per $100 per year on the amount between $1,500 and $3,000. In this case, a loan of $1,000 repaid in 12 monthly installments of $95.62 each would cost the borrower $147.44 in interest or an effective 26.18% APR. For larger loans, the annual percentage rate is lower. For example, the finance charge for a loan of $4,000 in Colorado under the Uniform Consumer Credit Code is $433.04 amounting to an annual percentage rate of 19.42%. The total of $4,433.04 is repayable in 12 monthly installments of $369.42 each. Obviously, it is very difficult to compare among these methods, which is why the annual percentage rate method was instituted as a standard.

TABLE 30

PERCENTAGE DISTRIBUTION OF LOANS MADE AT FINANCE COMPANIES IN 1985, BY CHARACTERISTICS OF BORROWERS

	Percent of Number of Loans Made to:	
	Second Mortgage Personal Loan Borrowers	Other Personal Loan Borrowers
By Annual Income		
$12,000 or less	12.6%	25.3%
$12,001 to $15,000	13.9%	23.3%
$15,001 to $24,000	27.3%	22.4%
$24,001 to $30,000	18.3%	14.0%
$30,001 to $36,000	11.0%	7.5%
Over $36,000	14.7%	5.9%
Not reported	2.2%	1.6%
TOTAL	100.0%	100.0%
By Age		
Less than 25 years	2.0%	10.1%
25 to 34 years	19.2%	34.3%
35 to 44 years	30.6%	26.0%
45 to 54 years	26.0%	16.6%
55 to 64 years	17.4%	10.2%
65 years and over	4.2%	2.0%
Not reported	0.6%	0.8%
TOTAL	100.0%	100.0%

Source: American Financial Services Association.

Terms of Finance Contracts

The maximum length of loan or sales finance contracts also is limited by legislation or regulation in each state although company policy may restrict maturities to a shorter term than that permitted by law.

Federal Reserve data reveal that in November 1986 new auto contracts written by major finance companies had an average length of 53.4 months. This figure has been rising for several years. Used car contracts in the same period had average maturities of 42.6 months, also up from earlier years. It should be noted here that this trend toward longer contract terms in auto loans has been observed as well for other types of consumer loans. Loan-to-value ratios at auto finance companies for new cars averaged 93% and for used cars 97%, compared with 86% and 93% three years earlier.

Consumer Borrowers

Traditionally, the "character" of the borrower was the significant factor considered by finance companies in granting loans. Except in the case of large loans, security in

TABLE 31

PERCENTAGE DISTRIBUTION OF U.S. HOUSEHOLD POPULATION BY ANNUAL INCOME AND BY AGE, 1985

By Annual Income

$5,000 or less	7.7%
$5,001 to $10,000	12.4%
$10,001 to $15,000	11.5%
$15,001 to $20,000	10.9%
$20,001 to $25,000	10.0%
$25,001 to $30,000	9.1%
$30,001 to $40,000	14.4%
$40,001 to $50,000	9.3%
$50,001 to $75,000	10.3%
Over $75,000	4.4%
Total	100.0%
Mean household income	$29,066

By Age of Householder

Less than 25 years	6.2%
25 to 34 years	23.1%
35 to 44 years	20.4%
45 to 54 years	14.8%
55 6o 64 years	14.5%
65 years and over	21.0%
Total	100.0%

Memo: Total number of households..(thousands)	88,458

Source: Bureau of the Census
Note: Parts may not add to totals due to rounding.

the form of tangible personal property frequently had little market value. To the borrower, however, it would have considerable subjective value and willingness to use it as security established evidence of good faith. Since the early days of finance company lending, however, legal changes, economic factors such declining demand for very small loans, and the emergence of alternative products (such as second mortgages) have led to the phasing out of the use of household goods as security for personal loans.

Table 29 reveals that the vast majority (almost 96%) of finance company real-estate secured personal loans were taken out for uses not involving the purchase or transfer of real estate. More specifically, seconds are now being used primarily to finance such activities as vacations, college tuition, home improvements, etcetera. A large portion (around 18%) of the smaller other personal loans were used to consolidate and/or refinance existing debts (Table 29).

The characteristics occurring most often among the second mortgage customers of

TABLE 32

ASSETS OF COMPANIES RESPONDING TO AFSA QUESTIONNAIRE, DECEMBER 31, 1985

	All Reporting Companies	Reporting Companies with Receivables of less than $1 Billion	Reporting Companies with Receivables of $1 Billion or more
	(In millions of dollars)		
Personal loans	32,394	4,687	27,707
Retail automobile paper*	80,338	1,365	78,972
Other consumer receivables	14,952	960	13,992
Business receivables**	72,134	356	71,778
Subtotal	199,817	7,369	192,449
Deduct reserves for unearned income	27,211	1,127	26,084
Subtotal	172,606	6,242	166,365
Deduct reserves for losses	3,018	154	2,865
Subtotal	169,588	6,088	163,500
Foreign Receivables (Net)	9,909	1	9,908
Cash and Noninterest deposits	1,348	68	1,280
Time Deposits	504	122	382
U.S. Gov't & Other Marketable Securities	11,481	167	11,314
Others Loans & Investment	1,789	82	1,707
Other Assets	12,787	191	12,596
TOTAL ASSETS	207,407	6,719	200,688
Number of companies	111	91	20
Number of offices	11,052	2,288	8,764

Source: American Financial Services Association
Note: Parts may not add to totals due to rounding.
* Includes retail automobile contracts for business purposes.
** Excludes retail automobile contracts for business purposes.

the surveyed companies include: age between 35 and 44 years, annual income between $15,000 and $24,000, occupations as operatives, laborers, managers, proprietors etc. Second mortgage loans are made most frequently in amounts between $5,000 and $10,000 (net of unearned charges). For other personal loan borrowers, age is younger, most frequently between 25 and 34 years, and annual income is lower, between $12,000 and $15,000. Occupations are again most frequently operatives, laborers, clerks, etc. and loans are most frequently made in net amounts between $2,000 and $5,000 (Table 30). Table 31 provides the income and age distributions of the 86,789,000 U.S. households in 1985 for purposes of comparison. Although the income brackets are slightly different, general comparison is possible. The most common household income in the overall population was between $30,000

TABLE 33

LIABILITIES, CAPITAL, AND SURPLUS OF REPORTING FINANCE COMPANIES, 1985

	All Reporting Companies	Reporting Companies with Receivables of less than $1 Billion	Reporting Companies with Receivables of $1 Billion or more
		(In millions of dollars)	
Bank Loans	6,046	1,425	4,621
Commercial Paper	72,623	526	72,098
Other Short-term debt	8,148	921	7,227
Deposit Liabilities and Thrift Certificates	3,816	1,281	2,535
Long-term Indebtedness (excluding subordinated debentures)	63,134	749	62,385
Subordinated Debentures	7,635	384	7,251
All Other Liabilities	26,418	528	25,890
Subtotal - Liabilities	187,821	5,814	182,007
Capital, Surplus and Retained Profits	19,586	905	18,680
TOTAL	207,407	6,719	200,688
Number of Companies Reporting	111	91	20

Note: Parts may not add to totals due to rounding.

Source: American Financial Services Association surveys.

and $40,000, and the most common age of householder was between 25 and 34.

Structure of the Finance Company Industry: AFSA Survey Results

The finance company industry has undergone many changes in the past few years, reflected in changes in AFSA's annual survey. Earlier reports had been designed to reflect characteristics of two distinct types of finance companies dealing with consumers: 1) consumer finance companies—those companies primarily engaged in making cash loans directly to consumers; and 2) sales finance companies—those companies primarily purchasing retail installment sales contracts from retailers and dealers. This division seemed appropriate for many years

TABLE 34

GROSS INCOME, EXPENSES AND NET INCOME OF REPORTING FINANCE COMPANIES, 1985

	All Reporting Companies	Reporting Companies with Receivables of less than $1 Billion	Reporting Companies with Receivables of $1 Billion or more
		(In millions of dollars)	
Sources of Gross Income			
Accounts receivable	24,203	1,181	23,022
Other	3,475	185	3,290
Total	27,678	1,366	26,312
Uses of Gross Income			
Expenses other than cost of borrowed funds:			
Wages and salaries	2,366	229	2,138
Advertising and publicity	180	20	160
Net losses and reserves	1,646	103	1,543
Other	5,522	260	5,262
Subtotal	9,714	612	9,103
Cost of borrowed funds	13,097	513	12,584
Federal income taxes	1,915	103	1,812
Net domestic income	2,951	138	2,813
Income from foreign receivables	124	0	124
Income from nonconsolidated subsidiaries	62	5	57
Total Net Income	3,137	144	2,994
Number of Companies Reporting	111	91	20

Source: American Financial Services Association.
Note: Parts may not add to totals due to rounding.
See Table 30 for number of offices covered in this report.

since each type of company had discrete attributes. Consumer finance companies generally made smaller loans, relied more heavily on long-term borrowing as a source of funds, and operated from more offices (with more operating overhead) per unit of receivables. Sales finance companies generally made larger loans (more frequently secured), and relied more on short-term commercial paper as a funds source.

Generalizations of this type, however, are no longer appropriate. In recent years many finance companies have diversified both their assets and their liabilities, especially

TABLE 35

RELATION OF INCOME TO OUTSTANDINGS, ASSETS AND EQUITY FINANCE COMPANIES, 1985

	All Reporting Companies	Reporting Companies with Receivables of less than $1 Billion	Reporting Companies with Receivables of $1 Billion or more
Finance charges collected as percent of year-end net outstandings.....	13.3%	20.3%	13.1%
Cost of borrowed funds and net income as a percent of total assets at year-end - TOTAL.....	7.8%	9.7%	7.8%
Cost of borrowed funds.....	6.3%	7.6%	6.3%
Net income after taxes.....	1.5%	2.1%	1.5%
Net income after taxes as a percent of capital, surplus and undivided profits.....	16.0%	15.9%	16.0%

Source: American Financial Services Association

the large companies. Consumer finance companies now often purchase installment sales contracts through their cash loan offices. Sales finance companies have entered the cash loan business. Both types of companies are also active in many forms of commercial financing, a particularly rapidly growing portion of the business of some companies. Although smaller companies are likely to be more specialized than large companies (usually in cash lending), many smaller companies have diversified in the last decade as well. Because of these changes, the main distinction among companies is now division by size of company rather than by type. Distributions of assets, liabilities, income, and other totals are presented separately for companies with receivables of $1 billion or more and for companies with receivables of less than $1 billion. Then, within these major size classifications, the same distributions are presented for companies with at least 50 percent of receivables in personal (cash) loans and for companies with less than 50 percent of receivables in personal loans.

Assets

The 1985 AFSA survey of finance companies obtained data from 111 companies, both large and small which operated 11,052 offices throughout the United States (Table 32). These companies had total assets of $207.4 billion at the end of 1985 including $200 billion in accounts and notes receivable of which $32 billion was in personal loans.

Of the 111 companies responding to the survey in 1985, 91 were "small" companies, according to the above-mentioned classification scheme. These companies had assets of $6.7 billion including personal loans of $4.7 billion. Of the 111, 20 were "large" companies and held assets of $200.7 billion and personal loans of $27.7 billion.

Liabilities and Sources of Funds

Finance companies take on all of the common forms of business organization, including the individual proprietorship, the partnership, and the corporation, with the latter predominating. Sources of funds have been generally the same as those of similar privately owned organizations in other fields of endeavor. Thus, finance companies have competed with all other types of businesses in funds markets. The only exceptions are in those states where industrial banking companies are chartered, and can compete for consumer deposits in addition to other sources of funds.

Aggregate liabilities, capital, and surplus of the surveyed finance companies are shown in Table 33. Data for all of the reporting companies combined show that the largest sources of funds (as a percent of liabilities and capital combined) were long-term debt (30.4%) and commercial paper (35.0%). Other sources of funds included: bank loans of 2.9%, deposit liabilities and thrift certificates of 1.8%, subordinated debentures of 3.7% and capital and surplus of 9.4%, down from 10.3% in 1984.

Income and Expenses

As finance companies' assets have diversified in recent years so have sources of income. New lines of business have included commercial lending, purchase of or merging with retailers, and leasing. Some finance companies, through subsidiaries, have entered or expanded insurance operations, writing not only credit life insurance but also other forms of insurance. In 1985, 12.6% of the gross income of 111 reporting finance companies came from sources other than accounts receivable (Table 34). Of total gross income, 8.5% was used for wages and salaries, 0.7% for advertising and publicity, and 5.2% for losses and addition to loss reserves. After paying out 47.3% of gross income as their cost of borrowed funds, income taxes of 6.9% of gross income were paid, leaving $3.1 billion in net income (11.3% of gross income).

Aggregate earnings ratios by company size groups are less revealing. The overall rate of return on invested capital, defined as net income (after payment of income taxes), and expressed as a percentage of net worth (capital, surplus and retained earnings), for the 111 reporting finance companies was 16% in 1985 (Table 35), higher than the 15.08% rate of 1984, and still going strong. The 20 large companies, combined earned 16.0% on invested capital in 1985, while the 91 small companies earned 15.9% comparable rate.

Regulation of Consumer Lenders

All of the federal and state statutes and regulations affecting corporations, partnerships and proprietorships generally apply to such organizations which provide consumer installment credit. This includes Federal Trade Commission, Securities and Exchange Commission, and various state and other regulations. In addition, finance companies are subject to a multitude of state financial institution statutes.

In most states, the provisions are enforced by a division of the Banking Department which is frequently empowered to supplement the statutes by promulgating rules and regulations. Elsewhere, similar powers rest with other agencies or departments. In Ohio, for example, it rests with the Director of Commerce and in California with the Commissioner of Corporations.

Many states' laws require consumer loan licensees to report regularly (usually annually) on their operations to the state supervisory authorities. In practically all states, annual examination by these authorities is required by law and examinations at other times are permitted. The costs of such examinations, in addition to the annual license fee for each operating office, are in most states borne by the licensees.

While large loans are made under various statutes, including in some states specific second mortgage laws, many of the smaller unsecured installment loans are still made under provisions of laws derived from the "Uniform Small Loan Law" originally promulgated by the Russell Sage Foundation in 1916, and the "Model Consumer

Finance Act" drawn up by the National Consumer Finance Association in 1948. The terms "Uniform Small Loan Law" and "Model Consumer Finance Act" have come to be used interchangeably. Regulatory features consist of provisions with respect to the following: 1) licensing by a state supervisory official, 2) supervision by a state supervisory official having powers to enforce and interpret the law, 3) authorization of adequate charges to permit complete service, 4) limitation of charges, 5) regulation of contract provisions, 6) disclosure of terms and status of loan transactions, 7) prohibition of evasions and subterfuges, and 8) penalties and enforcement powers. The history of this uniform code lies in an effort to create a regulatory environment similar in all jurisdictions, given the absence of a federal system for finance companies.

Uniform Consumer Credit Code

As various institutions such as finance companies, industrial banking companies, commercial banks, credit unions, retailers, savings and loan associations, and mutual savings banks entered the consumer credit business, the states' laws were amended. As a result, most states have in effect a number of laws which may vary as to rates, supervision, and other legal requirements placed on the various consumer creditors.

The Uniform Consumer Credit Code, which is an indirect descendant of the earlier-mentioned "Uniform Small Loan Law" and the "Model Consumer Finance Act", was designed as a single law to govern all consumer credit contracts and as a replacement for a multitude of differing state laws including small loan laws, sales finance and revolving credit laws, usury laws, and laws regulating insurance premium financing, home repair financing and second mortgage loans. Consumer credit as defined by the UCCC consists of loans and sale credit to individuals for personal, family, household, or agricultural purposes, including the purchase of a home or farm, when there is a charge for the credit or the credit is repayable in installments . The UCCC would regulate all consumer credit as defined for amounts up to $25,000, with provisions for increasing the ceiling based on increases in the Consumer Price Index.

The UCCC would fix the same maximum rates for all types of consumer credit grantors. Originally, for example, UCCC maximum rates for installment credit (loans and sales finance) were 36% per year on the first $300 loaned, 21% per year on the next $700, and 15% per year on the remainder, with the provision that steps would be increased based on changes in inflation. When these graduated rates yield less than 18% per year, the maximum would be 18% per year.

The UCCC also includes significant consumer protection provisions as to disclosure of contract terms, advertising, balloon payments, security, garnishment and other creditors' collection remedies, unconscionable or fraudulent conduct, "cooling-off" period for door-to-door sales, referral sales, recission of contracts secured by the debtor's home, and official surveillance and enforcement by an Administrator. There are heavy civil and criminal penalties specified for violations of the UCCC.

1974 revisions to the UCCC reflected changes in response to many of the recommendations made by the National Commission on Consumer Finance established by the Consumer Credit Protection Act. The revised UCCC substantially implements the National Commission's recommendations as to buyers' defenses in installment and credit card sales and in sale-related loans, deficiency judgements, service of process, limitations on garnishment, debt collection practices, door-to-door sales, and cosigner agreements.

The Uniform Consumer Credit Code has been adopted in Colorado, Idaho, Indiana, Kansas, Maine, Oklahoma, Utah and Wyoming. Other states, such as Louisiana, Alabama, West Virginia and Wisconsin, have passed general statutes containing various elements of the UCCC.

Consumer Credit Protection Laws

Finance companies and industrial banks, like all other creditors, are subject to the Federal Consumer Credit Protection Act and other laws which mandate special procedures concerning credit or information about consumer borrowers.

Federal protection of consumer borrowers began in 1968 with the passage of the Consumer Credit Protection Act. Title I of this legislation, the Truth in Lending Act, mandated that creditors disclose credit terms to promote the informed use of credit by consumers. It also required the Board of Governors of the Federal Reserve System to prescribe regulations to carry out the purposes of the act. Specific Federal agencies administer the Board's regulations. Pursuant to congressional instructions, the Board issued Regulation Z, which provided, among other things, for disclosure of the actual "finance charge" for credit and of the effective "annual percentage rate" to be calculated using standardized methods.

Since this initial action, the Congress has amended the Truth in Lending Act repeatedly and has also enacted new consumer credit laws as follows: Fair Credit Reporting Act (1970), Credit Card Amendments to Truth in Lending (1970), Technical Amendments to Truth in Lending (1974), Fair Credit Billing Act (1974), Equal Credit Opportunity Act (1974), Federal Trade Commission Improvement Act (1975), Home Mortgage Disclosure Act (1975), Equal Credit Opportunity Act Amendments (1976), Consumer Leasing Act (1976), Fair Debt Collection Practices Act (1977), Community Reinvestment Act (1977), and Electronic Fund Transfer Act (1978). As Title VI of the Depository Institutions Deregulation and Monetary Control Act of 1980, "Truth in Lending Simplification" was enacted.

The administrative structure for many of these laws parallels that of the Truth in Lending Act. The Congress states its general intent and instructs the Board of Governors of the Federal Reserve System to issue regulations that apply to institutions granting consumer credit. Thereafter the Federal agencies with primary supervisory responsibility for each class of creditors administer the Board's regulations for those creditors.

Report of the National Commission on Consumer Finance

The Consumer Credit Protection Act of 1968 also created a National Commission on Consumer Finance, whose duty was to study and appraise the functioning and structure of the consumer finance industry, as well as consumer credit generally. The Commission made its report to the President and Congress on December 31, 1972.

The Commission concluded that a truly competitive consumer credit market, with adequate disclosure of relevant facts to an informed consuming public, together with legislation and regulation to eliminate excesses, will foster economic growth and serve to optimize benefits to the consumer. As to excesses in the marketplace, the Report recommended significant additions to the protection of consumers in the fields of creditors' remedies and collection practices, urging restrictions on remedies such as garnishment, repossession and wage assignment, and recommending abolition of the holder in due course doctrine, confessions of judgement, and harassing tactics in debt collections.

The Commission's research studies contain the empirical data, information and analysis relied upon by the Commission. These six technical studies are as important as the Report itself and provide some data not available elsewhere.

One of the research volumes by the National Commission on Consumer Finance released early in 1974 (Technical Studies, Volume III), contains many tables of information on installment credit by states at mid-1971— the only attempt at a comprehensive state-by-state compilation.

Electronic Fund Transfer Systems

The development of Electronic Fund Transfer Systems (EFTS) has hastened an evolution in the payments system in which the commercial banking system is no longer

the exclusive vendor of the means of money transfer. A growing number of institutions and industries outside of banking are offering money or near-money deposit arrangements and providing money transfer services.

The major contenders for money transfer powers have been the nonbank depository institutions: savings and loan associations, mutual savings banks, credit unions and industrial banks. Non-depository consumer finance companies, credit card companies, retailers, insurance companies, and new institutions (such as money market funds) are displaying increased interest in the direct transfer of funds. Technology has been the instigator in this area and legislation has been passed which is permitting changes whereby commercial banks may be bypassed in funds transfers.

Over the past two decades, the operations of financial institutions have become increasingly computerized, but mostly in ways that did not directly affect the manner in which ordinary customers transact their financial affairs. In the last few years, however, the consumer has begun to be offered computerized services that take over some of the functions of checks and currency. Many depository institutions now offer automated deposit and withdrawal services; many social security recipients and employees have their checks deposited electronically into their accounts; and some consumers are able to pay bills directly, without the use of cash or checks. These services are being facilitated by the technology that has become known as electronic fund transfers (EFT).

To learn more about EFT and to obtain a variety of views on the appropriate public policy toward EFT, the Congress established the National Commission on Electronic Fund Transfers to study and report, with recommendations, on all aspects of EFT with which the Congress should be concerned.

The Final Report of the National Commission on Electronic Fund Transfers which was released on October 28, 1977, was divided into eight parts: The Commission and Its Work; The Consumer and EFT; Developmental Issues in EFT; Technology and EFT; Roles of the Federal Government in EFT; and International Developments in EFT. Part 7 offers the separate statements of various Commissioners on various issues. Part 8 provides a series of nine appendixes containing the text of the Act which established the Commission, the votes of Commissioners on certain recommendations, a description of the payments system in the United States, and several descriptive appendixes regarding the Commission's work.

The Report reflected the Commission's recognition that EFT was (and still is) in the midst of an evolutionary process and that only the first steps had at that time been taken in its potential development. The Commission adopted the principle that the growth of EFT should take place in a competitive environment, that EFT should be viewed as an alternative means to provide payment services and that all evidence suggested that the paper-based system will remain in operation indefinitely. The Commission also accepted the thesis that the future of EFT is inextricably tied to consumer acceptance.

Essentially the Commission viewed EFT only within the existing institutional framework. It did not attempt to offer alternative scenario for possible development in the future. By virtue of this approach, finance companies which offer only credit and have no deposit capability, were considered in relation to credit markets and information transfer services but not in relation to funds transfer services. In contrast, industrial banking companies, which offer passbook or other deposit-like consumer services, would be included among the thrift institutions and subject to the conclusions and recommendations of the Commission.

Depository Institutions Deregulation and Monetary Control Act of 1980

The Depository Institutions Deregulation and Monetary Control Act of 1980, which became law on March 31, 1980, will have as far-reaching effects on financial institutions as did the Federal Reserve Act of 1913 and the various banking legislation of the 1930's. Through its nine titles consisting of

101 sections, the Act will have impact on the operations of all financial institutions, both depository and non-depository.

The Act will change the nature of our monetary system. All accounts of depository institutions subject to transfer of funds to third parties are incorporated into our country's medium of exchange. To effect this modernization of the monetary concept, the Act introduced the concept of "transaction account" which is defined as any deposit or account on which the depositor or account holder is permitted to make withdrawals payable to a third party. The Act also introduced the concept of the "non-personal time deposit" which is a transferable time account in which any beneficial interest is held by a depositor who is not a natural person. Beginning September 4, 1980, all depository institutions (banks, savings and loan associations, and credit unions) were required to maintain reserves against such accounts. Members of the Federal Reserve System were to adjust to this new structure of reserve requirements over a three and one-half year period. Nonmember banks, savings and loan associations, credit unions, and industrial banks were to be phased into the reserve requirements over an eight-year period. Depository institutions subject to these reserve requirements also have access to the Federal Reserve services.

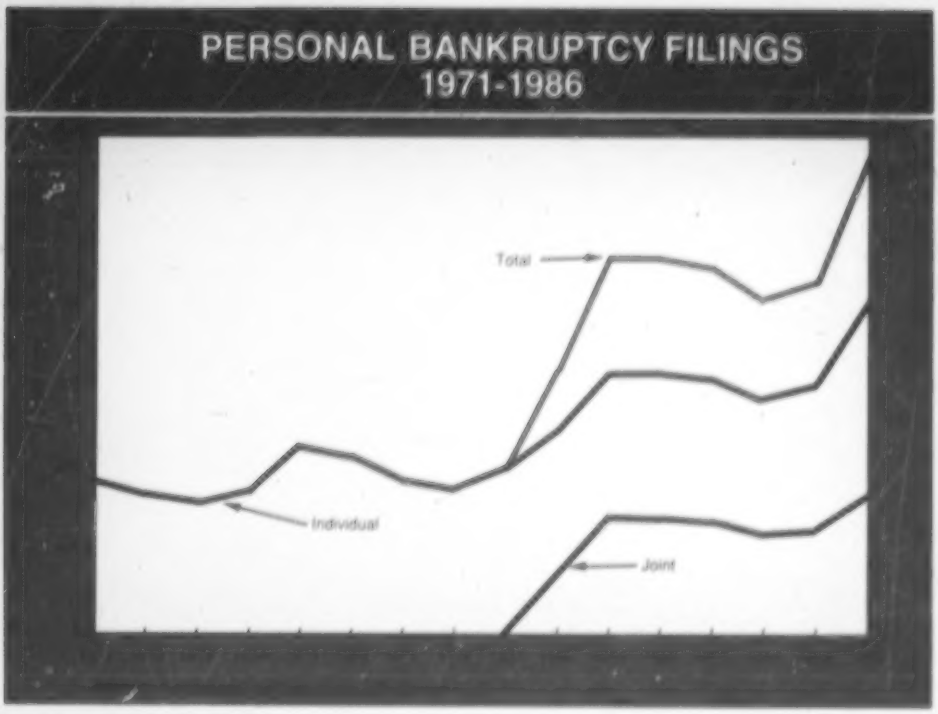
The Act continues to alter the form and substance of regulations applied to depository institutions. To monitor and control monetary and credit aggregates, the Federal Reserve Board requires reports of assets and liabilities of all depository institutions including those that are not federally insured. The latter is accomplished through such state officer or agency as the Board may designate. To phase out the limitations on maximum rates of interest on deposits (Regulation Q) over a six-year period, the Act created a Deregulation Committee consisting of the Secretary of the Treasury, the chairmen of the federal regulatory agencies of depository institutions, and the Comptroller of the Currency. The committee's assignment was to provide depositors with a market rate of return on their savings, a task largely complete by the end of 1982. On March 31, 1986, the last controls expired, except for the prohibition on paying interest on demand deposits.

The Act provided for a redefinition of money and near-money, that is, demand deposits, time deposits and saving deposits. The Deregulation Committee had the authority to prescribe rules governing the payment of interest by all federally insured depository institutions and to establish classes of deposits or accounts. This could be done by the gradual increase in such limitations, the complete elimination of limitations on particular accounts, the creation of new categories of accounts, the combination of any of these methods, or by any other method. On March 31, 1986, all powers transferred to the committee under the Act terminated and the committee ceased to exist.

The Act expanded both the assets and liabilities acceptable for savings and loan associations. Subject to regulations of the Federal Home Loan Bank Board, they may now engage in or participate in credit card operations, offer loans specifically related to negotiable order of withdrawal (NOW) accounts, offer mortgages under certain circumstances of over 90% of appraised value, offer second mortgages and offer, with limitations, consumer loans and commercial real estate loans. As a source of funds, savings and loan associations may now issue mutual capital certificates which may be used as a part of the general reserve and net worth but must be subordinate to all savings accounts, certificates and debt obligations. Any state (stock) savings and loan association that existed in stock form by March 31, 1976 may convert to a federal (stock) charter under specified conditions.

The Act preempted state usury ceilings permanently in certain instances and was subject to override by state action in others. Usury provisions of state constitutions or laws affecting first liens on residential real property and manufactured homes taken after March 31, 1980 were preempted subject to override by state action after April 1, 1980, and before April 1, 1983. A somewhat similar provision for business or agricultural loans of $1,000 or more applied,

CHART 23



except that a rate of not more than 5% above the Federal Reserve Bank discount rate was permitted. The preemption was subject to state override and expired on April 1, 1983. Insured state banks and thrift institutions, and small business investment companies may charge a rate of 1% above the basic Federal Reserve discount rate with no terminal date, but subject to state override. State restrictions on the rate of interest that may be paid on deposits were eliminated.

The Act amended the Truth in Lending Act to simplify and reduce the number and detail of disclosures and to make them more understandable. This part of the Act went into effect on October 1, 1982.

In summary, various sections of the nine titles of the Act have made and will continue to make changes in our financial system which will impact upon many aspects of the operations of industrial banking companies. The Act will introduce more competition to the lending operations of finance companies, their markets for funds, and the legal framework under which they operate. The Act has created a new status for savings and loan associations including opening the federal charter to corporate stock savings and loan associations.

In 1982 the Garn-St Germain Act spelled out more specifically some of the changes occasioned by the 1980 legislation and made some technical adjustments as well.

Five full years after the legislation was enacted the various financial services industries are becoming increasingly homogeneous.

Personal Bankruptcy

The 1978 Bankruptcy Reform Act, which took effect on October 1, 1979, was the first major revision to bankruptcy laws since 1938, and it introduced for the first time Federal-code exemptions from a bankrupt's assets available to creditors. Prior to that, property exemptions were established by state laws. The purpose of the Federal

exemptions was to assure that enough property would be available to the debtor so he could have a fresh start and resume his normal role in society. A goal of the 1984 Amendments was to rectify certain provisions that were judged to be too liberal and detrimental to creditors.

The bankruptcy code contains nine chapters. Chapters 1, 3 and 5 apply generally to all kinds of bankruptcies regardless of what type of relief the debtor is seeking. For consumer bankrupts, the two most important chapters in the code are Chapters 7 and 13 which provide the framework for personal bankruptcy. Both chapters 7 and 13 can be filed by debtors regardless of what type of relief the debtor is seeking. For consumer bankrupts, the two most important chapters in the code are Chapters 7 and 13 which provide the framework for personal bankruptcy. Both chapters 7 and 13 can be filed by debtors regardless of whether or not they are financially insolvent. Chapters 9 and 11 also offer debtors specific kinds of relief, but they most frequently involve business bankruptcies. Chapters 2, 4, 6, 8, 10 and 14 were once part of the Code but no longer exist. Finally, Chapter 12 was added to the code in October 1986 to incorporate the recent amendment "Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986".

Personal bankruptcy filings have increased dramatically over the years. Table 37 and Charts 23 and 24 illustrate best the situation for the last 15 years.

Chapter 7: "Liquidation"

This is the straight bankruptcy chapter and it offers complete discharge of bankrupts' debts. Chapter 7 bankruptcy provides for a liquidation whereby the debtor surrenders his or her non-exempt assets for liquidation and distribution to creditors. Since passage of the 1978 code revisions, a debtor is entitled to Federal or state exemptions under Chapter 7. When a Chapter 7 bankruptcy is filed, all property of the debtor (minus the exemptions) becomes part of the bankruptcy estate, which is subject to the control of the trustee before liquidation and distribution to the creditors. The states (36 of them as of April 1986) that do not allow their citizens to use Federal exemptions are: Alabama, Missouri, Alaska, Montana, Arizona, Nebraska, Arkansas, Nevada, California, New Hampshire, Colorado, New York, Delaware, North Carolina, Florida, North Dakota, Georgia, Ohio, Idaho, Oklahoma, Illinois, Oregon, Indiana, South Carolina, Iowa, South Dakota, Kansas, Tennessee, Kentucky, Utah, Louisiana, Virginia, Maine, West Virginia, Maryland and Wyoming.

Chapter 13: "Adjustment of Debts of an Individual With Regular Income"

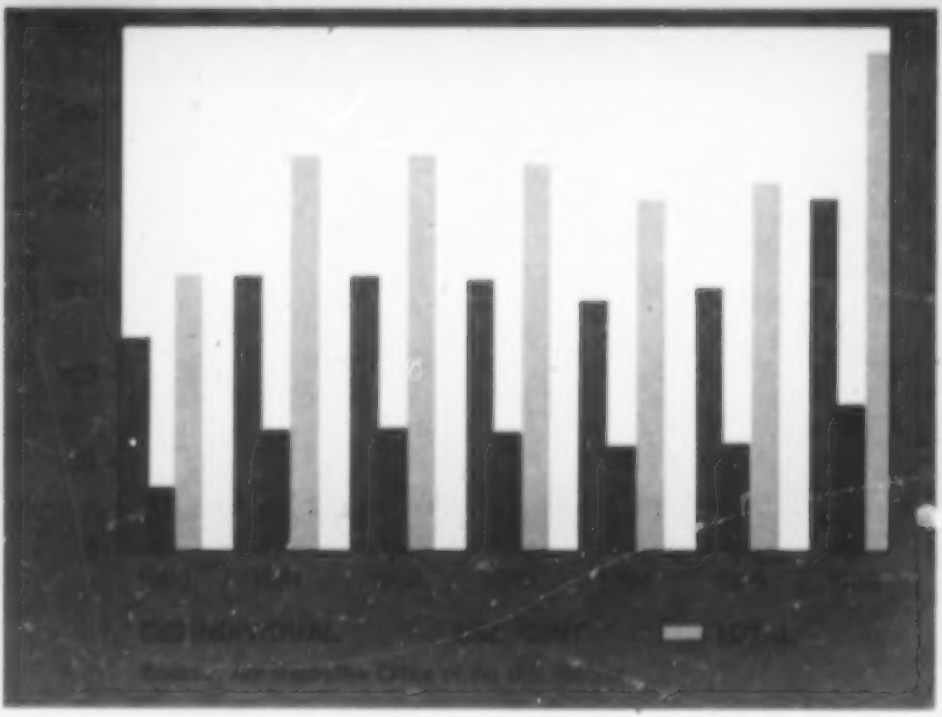
A Chapter 13 bankruptcy provides for a repayment plan whereby the debtor, with the court's approval, agrees to repay a portion of his or her debts out of future income while retaining all assets. Creditors would thus be paid over time under a specific schedule. The usual repayment period is 3 years, but the court can approve a longer period, not to exceed 5 years. The purpose is not to delay too much the debtor's fresh start. In determining how much money will be repaid to creditors, the court calculates the debtor's monthly take-home pay and how much is needed to cover monthly expenses. In addition, a small sum is set aside for unexpected expenses. The remaining income is the monthly repayment amount which is made to the Chapter 13 trustee for distribution to creditors. From the creditors' standpoint, Chapter 13 repayment plans are generally more successful than those of Chapter 7 because debt recoveries are made from the debtors' future income, rather than from (possibly negligible) proceeds of asset liquidation.

The 1978 Bankruptcy Reform Act

One of the main innovations of the 1978 Bankruptcy Reform Act was to allow spouses to file joint bankruptcy petitions and pay only one filing fee. In those cases, each spouse can claim the exemptions listed below. The stated purpose of the joint filing provision was to facilitate the consolidation of estates.

CHART 24

PERSONAL BANKRUPTCY FILINGS AFTER THE 1978 AMENDMENTS, 1980-1986



The code also established Federal exemptions and provided debtors the opportunity to use Federal or state exemptions unless individual states choose to opt out of Federal exemptions and set their own exemption levels. Some of the Federal exemptions are:

—Homestead not to exceed $7,500 for residential property.

—One motor vehicle not to exceed $1,200.

—Personal property not to exceed $200 per item for household furnishings and goods.

—Jewelry not to exceed a total of $500.

—Professional tools not to exceed a total of $750.

—A standard exemption not to exceed $400 plus any unused portion of the homestead exemption for any property not already specifically exempted. This last "wild card exemption" was meant to provide fairness to non-homeowners as well as homeowners whose equity in the home is less than $7,500.

Effects of the 1978 Act

One of the most dramatic results of the provisions of the 1978 Act is that couples filing jointly were able to choose separately and combine Federal and state exemptions. The General Accounting Office in a 1983 study showed that in joint filings, combining Federal and state exemptions can benefit couples by allowing them to exempt more property than if both spouses elected either

TABLE 36

PERSONAL BANKRUPTCY FILINGS, 1971-1986*

Year	Individual Filings	Joint Petitions	Total
1971	182,249	n/a	182,249
1972	164,737	n/a	164,737
1973	155,707	n/a	155,707
1974	168,767	n/a	168,767
1975	224,354	n/a	224,354
1976	211,348	n/a	211,348
1977	182,210	n/a	182,210
1978	172,423	n/a	172,423
1979	196,976	n/a	196,976
1980	241,439	73,432	314,871
1981	311,690	138,040	449,730
1982	311,443	138,643	450,086
1983	304,916	134,952	439,868
1984	281,755	118,664	400,419
1985	297,885	122,609	420,494
1986	401,575	167,367	568,942

*As of June 30.

Note: Joint petitions were allowed only after October 1, 1979, when the 1978 Bankruptcy Act took effect.

state or Federal exemptions. Here are the mean values in 1983 of exemptions for couples claiming:

—Federal exemptions only: $6,763
—state exemptions only: $9,652
—a combination of state and Federal exemptions: $27,608

Lenders complained about the 1978 Act, which they saw as being too liberal and allowing individuals with demonstrated ability to repay to evade repayments. More specifically, creditors felt that some bankrupts who filed for straight bankruptcy (Chapter 7) were otherwise eligible to file under Chapter 13. Creditors argued that the new code contributed to the dramatic increase in bankruptcy cases they faced together with increasingly expensive and fruitless recovery actions. They correctly argued that this expense was being passed on to those consumers who were meeting their obligations in good faith. Creditors agreed, however, that some of the increase in bankruptcy cases was also brought about by the economic recession of 1982 and the beginning of advertising by bankruptcy attorneys.

The 1984 Amendments

After much activism by AFSA and other members in the National Coalition for Bankruptcy Reform, and after many complaints brought to the attention of the House and the Senate, comprehensive bankruptcy legislation was signed into law by President Reagan in July 1984. It became effective on October 8, 1984, 90 days after the enactment of the bill. Only those cases filed after this date are affected. Some of the major amendments are:

—Ability of the bankruptcy court on its own motion to dismiss a bankruptcy case if it finds that the granting of relief would be a substantial abuse of the bankruptcy system. This provision, however, denies the right to move for dismissal to any "party in interest," preventing the creditors from using what could have been a powerful defensive weapon.

—Required documentation by the debtor and his attorney that the debtor was made aware of alternative relief under different chapters.

—Choice by debtors of either state or Federal exemptions in joint filings. If they cannot agree, they are deemed to have chosen Federal exemptions unless, of course, the state requires its citizens to elect state exemptions.

—Aggregate exemption for household goods of $4,000.

—Exemption of debtor's aggregate interest in any property not to exceed $400 plus up to $3,750 of any unused amount of the value of a residence used by the debtor or a dependent.

—Presumption of non-dischargeability of debts exceeding $500 in aggregate for luxury goods incurred within 40 days of petition, and for open-ended credit exceeding $1,000 in aggregate obtained within 20 days of petition.

—No court approval is needed to reaffirm a debt if the debtor is represented by counsel, agreement is filed with the court, and counsel declares that reaffirming the debt will not impose undue hardship on the debtor.

The 1984 Amendments also carry other provisions that recognize the rights of all parties concerned. For instance, a debtor is given the right to refile for relief under a different chapter if a previous filing proved impractical or impossible. On the other hand, the trustee has to make sure that the debtor surrenders collateral or starts making prompt repayments to the creditor. Payments under a Chapter 13 plan must begin within 30 days after the plan is filed with the court unless the court orders otherwise. Failure to comply results in the dismissal of the case. In fairness to the creditor, the debtor is required to submit a schedule of current income, assets and living expenses.

AFSA's Position and Efforts

AFSA's position, simply stated, is that debtors in financial distress, i.e., too heavily burdened and unable to pay, should be granted relief. Those able to afford to meet their obligations, however, should pay their creditors back and not abuse the creditors' and the court's good faith. In other words, bankruptcy filing should be a last resort action rather than a first choice.

Furthermore, creditors contend that the issue is not ultimately a conflict of the credit industry versus consumers but of non-paying consumers versus paying consumers: as costs rise because of bankruptcy losses, creditors must either increase rates of charge, restrict credit availability to improve credit quality, or impose more onerous credit requirements, perhaps by requiring additional collateral on credit extensions. Bankruptcy costs ultimately are paid by a transfer of wealth from consumers who do pay their debts to those who do not.

AFSA was originally involved in spearheading the National Coalition for Bankruptcy Reform, which is an inter-industry group that urged the passage of the 1984 Amendments. Perhaps the most significant change was the recognition that discharge of debts through the bankruptcy process is not a matter of right but a privilege which should not be abused. Recently, working in cooperation with the U.S. Department of Justice, AFSA filed in November 1986 a motion in support of the constitutionality of the "substantial abuse" provision in the 1984 Bankruptcy Act Amendments. That provision gave bankruptcy judges authority to dismiss a bankruptcy case if it represents a substantial abuse of the bankruptcy system, that is, if the debtor clearly was able to repay his debts. Whereas the 1984 Amendments, as explained above, enabled only the judge "on his own motion" to move to dismiss a case, a recent amendment also gave to the U.S. trustee the authority to bring questions

of substantial abuse to the attention of the bankruptcy court. AFSA, in comments and testimony to the U.S. Judicial Conference, had urged the passage of such an amendment. It was signed by President Reagan in October 1986 under the name of "Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986." Concerning the farmers, this bill created a new Chapter 12 of the bankruptcy code and allowed farmers holding as much as $1.5 million in debt to declare bankruptcy and seek protection from creditors. Such cases would in the past have been filed under Chapter 11 or, in some instances, under Chapter 7. A family farmer is defined as "an individual or a closely held corporation whose aggregate debts do not exceed $1.5 million, with 80% of the debt arising out of a farming operation."

The Economy in the 1980's

Probably the most important, as well as the most acclaimed economic characteristic of the early 1980's was the significant slowdown in inflation, from the double-digit levels of previous years to a 6.1% increase for 1982, as measured by the Bureau of Labor Statistics' consumer price index annual averages and changes. Credit for this progress is largely attributed to the Federal Reserve, as the result of its anti-inflationary monetary policy adopted some five years ago.

The economy began to pick up in 1983 after interest rates fell. While the Fed and the Reagan Administration disagreed loudly on whether tight money or unprecedented deficits projected to be over $200 billion would cause rates to either slow their decline or even to rise again, both agreed with economists that unless interest rates made it more attractive to borrow and invest money in productive activity, they could choke off the recovery. Interest rates turned out to be comparatively stable throughout 1983, rising only slightly during the second half of the year.

Recovery continued not at all tenuously, however, with nominal Gross National Product rising a total of 7.6% during the year and real GNP growing 3.6%. The strength of this recovery was surprising to many who had anticipated much more lethargic improvement. Employment increased markedly, as did industrial production and the utilization of capacity in manufacturing. Unemployment fell while the labor force grew consistently, and the Commerce Department's indexes of leading and coincident economic indicators signalled continued if slightly slower growth during 1984. The increasing interest rates observed at the end of 1983 and in early 1984 continued during approximately half of 1984, before they began to decline again, a trend which continued through the year.

1984 turned out to be an extremely strong year for the economy as a whole, GNP growing 10.5% in nominal dollars and 6.4% in real (1982) dollars. The $359 billion (current-dollar) increase was composed primarily of $194 billion from consumers in the form of increased personal consumption expenditures. Private domestic investment of all types increased by $160 billion. Government spending rose by $58 billion (48% of it federal and 52% state and local). Finally, the excess of imports over exports drained $53 billion more from the U.S. economy in 1984 than in 1983. The bulk of economic growth during 1984 thus took place in the consumer and business sectors.

During 1984 industrial production and capacity utilization for all industries rose 11.2% and 8.4% respectively over their average 1983 levels. The index of industrial production reached an annual average of 121.8% of its 1977 level, and the percent of capacity utilized in all industries averaged 81.0.

During this year of very strong economic growth, inflation did not reappear as a major threat to economic progress and in fact was lower than during recession-year 1982. The increase in the annual average of the Consumer Price Index for Urban Consumers (CPI-U) was 4.3% in 1984. This was slightly more of an increase than occurred during 1983 (3.2%), which is not surprising, given the overall level of economic activity during the more recent period. Both of these increases show continued success

in avoiding the high levels of inflation that occurred prior to 1982.

The major areas of concern to economy-watchers in 1984 were the foreign trade and federal government deficits. The trade deficit, a new phenomenon for the U.S., increased tenfold in 1984, reaching $59 billion. The federal deficit shrank slightly during 1984 to $170 billion, but remained more than two-and-a-half times as large as the 1980 deficit.

The economy slowed distinctly in 1985 from its rapid growth in 1984. Overall growth in nominal GNP was 6.2% for the year, 2.7% in real terms. Contributing to the $233 billion nominal growth was $172 billion in additional consumption spending and $82 billion in government spending. Gross domestic investment was $1 billion less than in 1984, and the foreign trade sector showed imports exceeding exports by $20 billion more than last year.

Industrial performance in 1985 was weaker than in 1984. Capacity utilization generally declined across the year, the December ratio for all industries of 80.6% being about the same as the year's average 80.4%, which was 6 tenths of a point below the 1984 average. The industrial production index followed a similarly flat course during the year, although it did turn upward slightly in the fourth quarter. In December the index was at 125.6% of its 1977 level, just above the annual average of 123.8%. That annual average was 2.0% above last year's, a pale performance compared to the 11% increase during 1984.

Consumer prices, however, brought encouraging news in 1985, increasing only 3.7%. Unfortunately, some of that mildness was due to rapidly falling oil prices at the end of the year, which were accompanied by serious problems in that industry and in certain regions of the country.

Neither the foreign trade nor the federal government's deficits became of any less concern during 1985. Both increased faster than GNP, the federal deficit coming in just a hair under $200 billion for the year (despite the savings from closing the Smithsonian buildings and the Library of Congress in evening hours).

In spite of such massive borrowing by Washington, the weakness in investment and decline in inflationary expectations allowed interest rates to come down during the year as a whole. The prime rate was lowered from 10.75% at the beginning of the year to 9.5%. Average monthly rates on finance company commercial paper fell from 8.55% in December of 1984 to 7.62% 12 months later, and on AAA corporate bonds from 12.13% to 10.16% (Chart 25).

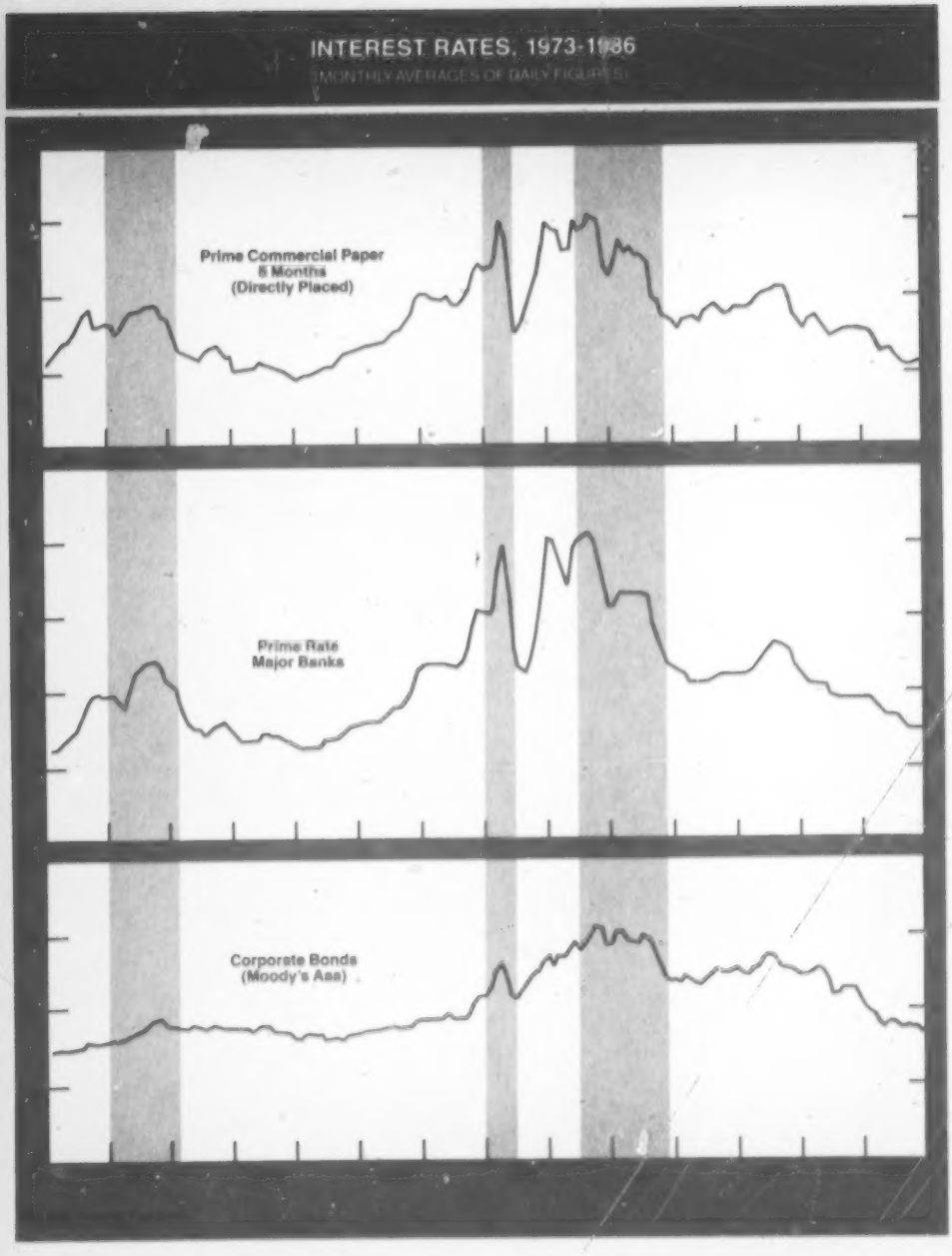
1986

Although the economy lost in 1986 some of the momentum it gained in 1985 and especially in 1984, it remained healthy, continuing a long economic recovery that started in late 1982. Overall growth in nominal GNP in 1986 was 5.2%, 2.5% in constant dollars. The $208 billion nominal increase was divided among the $162 billion growth in personal consumption expenditures, a $22.5 billion increase in gross private domestic investment, almost a $50 billion growth in government spending, and a $25 billion increase in the size of the trade deficit, enough to prompt some members of Congress to clamor for protectionist legislation.

The trade deficit was not even helped much in 1986 by a substantial decline in the value of the dollar against other major currencies. The need to finance this and other deficits caused the U.S. to borrow heavily from foreigners. Thus after being in 1982 the world's largest creditor nation, and only a year after becoming a net debtor, the U.S. became in 1986 the world's largest debtor. The amount of U.S. assets held by foreigners was larger by nearly $264 billion than the amount of foreign assets held by U.S. investors. This led some economists to worry about who will carry the burden of heavy interest payments to foreign investors. Others see the inflow of foreign capital as an encouraging measure of foreign confidence in the U.S. economy.

For its part, the budget deficit reached over $203 billion, also causing an outcry by some about the need for a balanced-budget constitutional amendment. Resolu-

CHART 25



tion of the deficit problem appears to be made harder by the inherent disagreements over spending policy between the Reagan administration and a Democratic Congress.

Although the increase in consumer spending was less than in 1985, it remained a substantial driving force in 1986, continuing economic recovery at a time when other economic indicators were faltering. Because of a drop in oil prices (increases are to be expected in 1987 however since OPEC is devising newer and more cohesive

policies), the Consumer Price Index showed its lowest growth rate in 25 years. Despite a surge in food prices, the CPI grew by only 1.9% in 1986.

Industrial performance in 1986 was weak. The capacity utilization ratio for all industries in December was 79.6%, just above the year's average of 79.4% which itself was one full point lower than in 1985. The sharpest drop in capacity utilization occurred in the second quarter of 1986 when the ratio fell from 80.0 to 79.2. Regarding industrial production, its index reached 126.7 in December. The 1986 average was 125.1, only 1.1% above 1985's.

As in 1985, interest rates kept going down. The prime rate fell to 7.5% in December 1986, while rates on AAA corporate bonds fell to 8.43% and on financial company commercial paper to 5.88% (see chart 25).

One of the major political milestones reached during 1986 was the tax overhaul which affected every sector in the U.S. economy. Briefly, the bill lowers the maximum income tax rate for individuals from 50% to 28% although some high-income taxpayers will pay a marginal tax rate of 33%. The maximum rate for corporations will fall from 46% to 34%. It is not all good news for consumers however since the bill will eliminate more than $300 billion of special tax breaks and deductions, such as the deduction of consumer interest payments on credit not related to home ownership. While the major concepts of the new tax bill are probably here to stay, it is likely that its rates will not remain intact for very long. Despite President Reagan's adamant opposition to raising taxes, some Congressmen have pointed up the need to increase taxes to help reduce the Federal budget deficit.

Judging from what the early months of 1987 brought us, the trade deficit issue with the resulting calls for protectionist legislation will be another major issue at stake. The weakening dollar, while it fell almost to the point of hurting the economy through higher inflation and interest rates, still has not resolved this question. In the realm of inflation, despite recent increases in oil prices, the CPI is not likely to increase much. As far as interest rates are concerned, banks have already started raising their prime rates, citing rising costs of funds and expected losses on loans to Third World countries. The budget deficit remains as much a problem, if not more so, than ever. Finally, another new element in the economic equation is the nomination of Alan Greenspan to head the Federal Reserve Board. He is a well-known proponent of financial deregulation.

Thus, from all points of view, 1987 is likely to be a period of great change and the year of confrontation between the Democrat-minded Congress and the Republican administration, with both sides striving to gain the upper hand and get ready for the upcoming 1988 elections.

LIST OF REFERENCES

Publications listed below are suggested primarily as sources of information on the consumer finance industry. A well stocked library should have them available. A detailed listing of the publications and other services of the American Financial Services Association may be found in the *AFSA Services Catalog*.

AFSA Research Report on Finance Companies / Published annually by Research Services, American Financial Services Association.

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